



Report to the Ranking Member,
Committee on Small Business,
House of Representatives

January 2016

SMALL BUSINESS INVESTMENT COMPANIES

Characteristics and Investment Performance of Single and Multiple Licensees

Accessible Version

GAO Highlights

Highlights of [GAO-16-107](#), a report to the Ranking Member, Committee on Small Business, House of Representatives

Why GAO Did This Study

Under the SBIC program, SBA licenses privately owned and managed investment funds that provide capital to small businesses. SBICs use their own capital plus funds (known as leverage) that are borrowed at favorable rates because SBA guarantees the loan obligation, which is known as a debenture. Holders of SBIC licenses can manage a single SBIC (“single licensee”) or two or more SBICs (“multiple licensee”).

This report examines (1) the characteristics of single- and multiple-license SBICs, (2) the investment performance of single versus multiple licensees and the attributes of the small businesses in which they invest, and (3) the SBIC program’s overall financial performance and the extent to which SBA manages program risk. GAO analyzed SBA data (generally covering from 2005-2014), policies, processes, and procedures and interviewed SBA staff, SBIC fund managers, and industry stakeholders, who were selected to represent a mix of SBIC characteristics and based on suggestions by various stakeholders.

What GAO Recommends

GAO recommends that SBA provide guidance to SBIC licensees on how to collect and report data on their investments in minority-, women-, and veteran-owned businesses. SBA neither agreed nor disagreed with this recommendation.

View [GAO-16-107](#). For more information, contact Cindy Brown Barnes at (202) 512-7215 or BrownBarnesC@gao.gov.

January 2016

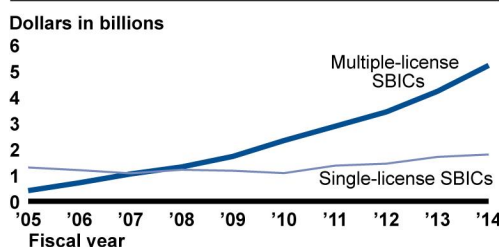
SMALL BUSINESS INVESTMENT COMPANIES

Characteristics and Investment Performance of Single and Multiple Licensees

What GAO Found

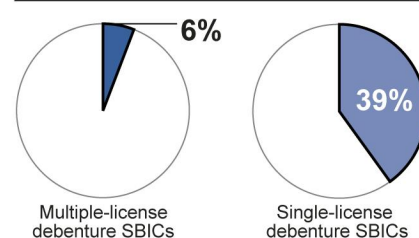
Small Business Investment Companies (SBIC) managed by entities holding multiple licenses controlled most Small Business Administration (SBA) leverage and shared similar characteristics with entities holding a single license. At the end of fiscal year 2014, multiple licensees controlled \$5.2 billion of the \$7 billion (about 74 percent) in outstanding debenture SBA leverage, compared to 2005, when they controlled 24 percent (see figure, left). SBIC characteristics, including geographic distribution and management demographics, were largely similar for single and multiple licensees.

SBA leverage held by debenture Small Business Investment Companies (SBIC)



Source: GAO analysis of Small Business Administration (SBA) data. | GAO-16-107

Percent of debenture SBICs transferred to liquidation, September 30, 2005 to July 15, 2014



Multiple licensees have demonstrated better aggregate investment performance than single licensees, although the investments have similar attributes. For example, from 2005 to 2014, 6 percent of multiple-license debenture SBICs were put into liquidation (typically because of excessive losses), compared with 39 percent of single-license SBICs (see figure, right). Both types of licensees invested in a roughly similar range of industries and geographic areas. Multiple-license SBICs were slightly more likely to invest in smaller enterprises or in low- or moderate-income areas. However, data on minority, women, and veteran ownership of SBIC investments are unreliable, in part because SBA does not provide guidance to SBIC licensees on how to collect and report this information. Providing such guidance would help improve the quality, consistency, and value of these data, which would help inform SBA’s strategic priority of providing financial capital for underserved small businesses.

The SBIC program’s financial performance has been relatively stable in recent years, although the degree to which program performance can be attributed to SBA oversight is unclear. For instance, most losses from 2003 to 2014 were incurred from SBICs remaining in the participating securities program (where SBA held an equity interest in SBICs), for which SBA stopped issuing new licenses in 2004 due to losses. The SBIC program’s risk management mechanisms include the application and licensing processes, which are largely the same for single and multiple licensees, and requirements for private capital fundraising. SBA monitors SBICs through risk assessments of their financial condition; examinations assessing regulatory compliance; and, as necessary, liquidation to recover financial assets. The effect of SBA oversight on financial performance is difficult to measure, however, because it cannot easily be isolated from other internal and external factors, such as economic conditions.

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Abbreviations

OIG	Office of Inspector General
SBA	Small Business Administration
SBIC	Small Business Investment Company



January 27, 2016

The Honorable Nydia M. Velázquez
Ranking Member
Committee on Small Business
House of Representatives

Dear Ms. Velázquez:

The Small Business Investment Company (SBIC) program provides financial assistance to privately owned investment firms that make equity and debt investments in small businesses. An entity can have a license from the Small Business Administration (SBA), which administers the program, to own or operate a single SBIC, or it may have two or more SBIC licenses.¹ SBA typically provides funds, known as leverage, in the amount of \$2 for every \$1 an SBIC has raised in private capital, up to a maximum of \$150 million for a single licensee and \$350 million for a multiple licensee. Collectively, SBICs held approximately \$7.7 billion of SBA leverage as of September 30, 2014.

You asked us to review aspects of the SBIC program. This report examines the (1) characteristics of multiple-license SBICs compared with single-license SBICs; (2) investment performance of multiple licensees compared with single licensees and the attributes of the small businesses in which they invest; and (3) overall financial performance of the SBIC program and the extent to which SBA manages the risk associated with the program.

To address the first two objectives, we collected and analyzed data from SBA on the number of SBICs, the amount of leverage extended to them, and the characteristics of the licensees. We also collected and analyzed measures of investment performance, such as loss rates, for single and

¹For this report, we use “single licensee” to refer to an entity that holds one SBIC license and “multiple licensee” to refer to an entity that holds two or more SBIC licenses under common control. “Common control” is defined as “a condition where two or more persons, either through ownership, management, contract, or otherwise are under the control of one group or person.” 13 C.F.R. §107.50. We use “single-license SBIC” to refer to an SBIC held by a single licensee, and “multiple-license SBIC” to refer to an SBIC held by a multiple licensee.

multiple licensees, and reviewed attributes of their investments that included geographic distribution, industry sector, and extent of investments in smaller enterprises. In most cases, our analysis covered 2005 through 2014 because 2005 was the year in which SBA began collecting data in a manner that allowed the performance of multiple versus single licensees to be isolated. Our analysis of the geographic distribution of SBIC investments covered October 1989 to June 2014 because that is the time frame of the data provided to us by SBA. In addition, we reviewed data collected by SBA on the minority, women, and veteran ownership of the small businesses in which SBICs invest.

To address the third objective, we reviewed and analyzed SBA data on SBIC program performance, including financial losses and credit subsidy rates, for fiscal years 1992 through 2014. To assess the reliability of the SBA data, we performed electronic testing for obvious errors in accuracy and completeness and discussed data collection procedures with SBA staff. We determined these data were sufficiently reliable for the purpose of this report, with the exception of data on minority, women, and veteran ownership of SBIC investments, as discussed later in the report. We also reviewed SBA's policies, processes, and procedures, including the program's application and approval process, examination procedures, oversight and audit practices, and financial reporting requirements. In addition, to address all the objectives, we interviewed a nongeneralizable sample of SBA staff, SBIC fund managers, other industry representatives, and an academic researcher. We selected the SBIC fund managers who we interviewed to represent a mix of multiple- and single-license SBICs, geographic locations, size of investments, and industries, among other criteria. We selected the academic researcher to interview based on a suggestion by the Small Business Investor Alliance and because his work was cited in documents we reviewed. See appendix I for a detailed discussion of our scope and methodology.

We conducted this performance audit from July 2014 to January 2016, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The Small Business Investment Act of 1958, as amended, created the SBIC program to facilitate the flow of capital to small businesses and

stimulate the economy.² Under the program, which is operated by SBA's Office of Investment and Innovation, SBA does not make direct investments in small businesses but partners with privately owned and managed SBICs that provide financing to qualifying small businesses. This financing consists of private capital that the SBIC has raised and SBA's financial assistance through the SBIC program. SBICs are able to borrow at favorable rates because SBA guarantees the loan obligations (known as debentures) that SBICs make.³ When an SBIC is ready to make an investment, in addition to using private capital, it may draw down on SBA's leverage by issuing a debenture with a repayment schedule for principal and interest. SBICs also may use their leverage and private capital to pay for operating expenses.

Entities applying for an SBIC license must raise the needed capital for an investment fund. The fund develops its own strategy for making investments in small businesses, offering loans, purchasing equity, or both. Generally, applicants must raise a minimum of \$5 million of private capital to establish an SBIC.⁴ As seen in figure 1, SBA typically provides \$2 of government-guaranteed leverage for every \$1 of private capital an SBIC has raised from private investors.⁵ These investors can include university endowments, insurance companies, banks, high-net-worth individuals, and pension funds.

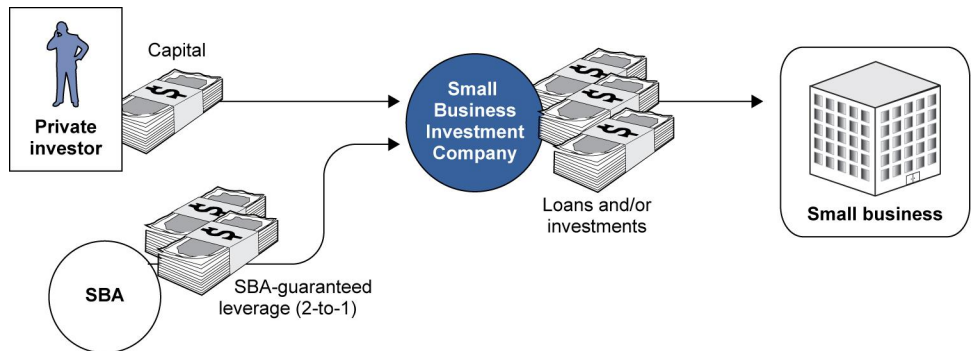
²Pub. L. No. 85-699, 72 Stat. 689 (codified as amended at 15 U.S.C. §§ 661-697g).

³SBA is also authorized to purchase debentures or participating securities issued by SBICs. 15 U.S.C. § 683(b). The participating securities program will be discussed further below.

⁴13 C.F.R. § 107.210.

⁵SBA is permitted by law to provide a maximum of \$3 of leverage for every \$1 of private capital up to the leverage limits of \$150 million for single licensees and \$350 million for multiple licensees. 15 U.S.C. § 683(b)(2). However, according to SBA, to manage program risk the agency typically provides \$2 of leverage for every \$1 of private capital.

Figure 1: Flow of Small Business Administration (SBA) Leverage and Private Capital in the Small Business Investment Company Program



Source: GAO; Art Explosion (images). | GAO-16-107

Holders of SBIC licenses may own or operate a single SBIC or multiple SBICs (sometimes referred to as multiple licenses under common control).⁶ An SBIC can be organized as a corporation, limited partnership, or limited liability company. Most SBICs are owned by relatively small groups of local investors, although some are wholly or partially owned by commercial banks. A few SBICs are corporations with publicly traded stock. SBICs can invest in small businesses with tangible net worth not in excess of \$19.5 million and with an average of not more than \$6.5 million in net worth after federal tax income over the previous 2 fiscal years at the time of investment.⁷

In fiscal year 2014, SBA committed to guarantee \$2.55 billion in SBIC small business investments. The Consolidated Appropriations Act, 2014, increased the annual amount that SBA was authorized to provide to SBICs from \$3 billion to \$4 billion.⁸ However, according to SBA, the SBIC program operates on a “zero-subsidy” basis at no cost to taxpayers, and requires no annual appropriations from Congress. To recoup expenses from any defaults and keep the program at zero subsidy, SBA charges SBICs various fees.

⁶For this report, the designation of an SBIC or SBIC licensee as “single” or “multiple” refers to its status during the specific year noted. However, an entity’s status as single or multiple licensee is not necessarily static. For example, all multiple licensees were once single licensees and a multiple licensee can revert to a single licensee if it surrenders one or more of its licenses.

⁷13 C.F.R. § 121.301(c). A business also may be deemed “small” using the North American Industry Classification System.

⁸Pub. L. No. 113-76, Div. E, tit. V, 128 Stat. 5, 223.

These include a 1 percent fee on the leverage commitment, a 2 percent fee when drawing against this leverage commitment, and an annual charge against the outstanding leverage balance. By statute, the annual charge may not exceed 1.38 percent, and historically it has never exceeded 1 percent, according to SBA.⁹ In addition, SBA is allowed by statute to charge licensing and examination fees to recoup administrative costs associated with these activities.¹⁰ Overall, the SBIC program's administrative expenses as a share of the SBA leverage (including commitments) declined from 0.24 percent in 1999 to 0.16 percent in 2013, according to SBA, which noted that the program has grown in recent years without a corresponding increase in administrative resources.

Currently, there are three types of debenture SBIC licenses. The Standard Debenture License has a broad investment mandate with few restrictions on an SBIC's strategy or capital allocation. The Impact Investment License requires that at least 50 percent of the fund's invested capital be deployed into investments that have a social, environmental, or economic impact.¹¹ The Early Stage SBIC license is designed to attract investment fund managers with experience supporting companies in the earliest stages of growth.¹²

In addition to the debenture program, the participating securities program, which started in 1994, helped fund SBICs through the issuance of preferred equity interests, called participating securities. On October 1, 2004, SBA stopped issuing new commitments because, according to the agency, the program experienced significant losses due to flaws in the participating securities instrument that were magnified as investments in technology startup and early stage small businesses lost much of their value in the early 2000s. According to SBA, the profit participation and

⁹15 U.S.C. § 683(b).

¹⁰15 U.S.C. §§ 681(e) and 687b(b). For fee amounts, see 13 C.F.R. §§ 107.300 and 107.692.

¹¹Impact investments include, but are not limited to, certain small businesses located in low- or moderate-income, economically distressed, or rural areas, energy-saving qualified investments, and grant recipients of the Small Business Innovation Research and Small Technology Transfer Research programs. They also can include other "impact" investments identified by the SBIC and approved as eligible by SBA.

¹²For this report, we use the terms "debenture SBICs" or "SBIC debenture program" to refer to SBICs with Standard Debenture Licenses, Impact Investment Licenses, and Early Stage SBIC Licenses.

fees paid for participating securities leverage were no longer sufficient to cover the projected net losses, and Congress did not appropriate any additional funds for the program. SBA continued to honor its existing commitments to the remaining participants as of 2016.¹³

Multiple Licensees Controlled Most SBA Leverage and Shared Similar Characteristics with Single Licensees

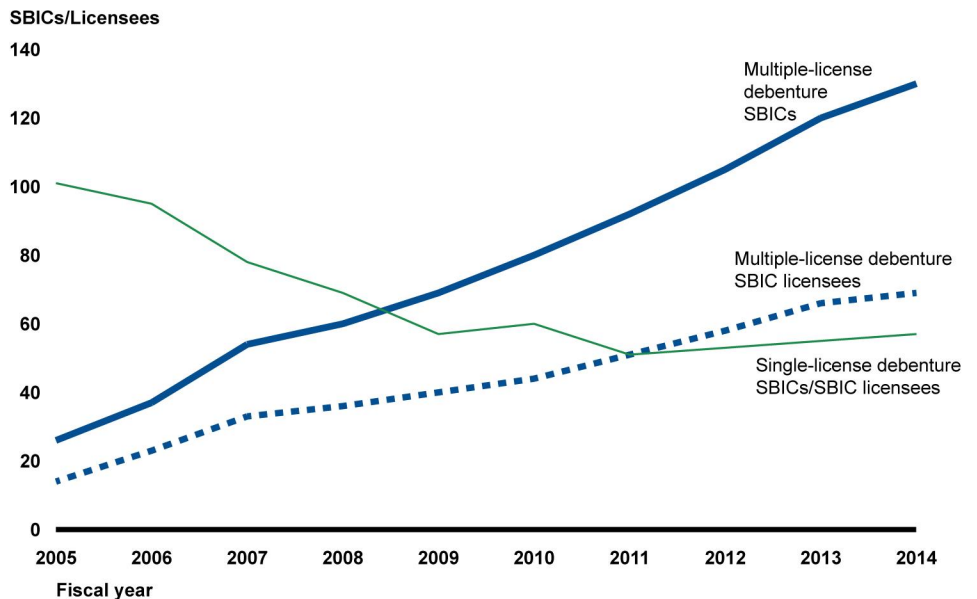
Multiple Licensees Controlled Most SBICs and SBA Leverage in 2014

About seventy percent (130 of 187) of debenture SBICs—the most common SBIC fund type—were managed by 69 multiple licensees in 2014, according to our analysis.¹⁴ The other 57 debenture SBICs were managed by single licensees (see fig. 2). The proportion of debenture SBICs managed by multiple licensees has sharply increased, rising from about 20 percent in 2005 to about 70 percent in 2014. At the same time, the number of single-license debenture SBICs generally decreased.

¹³In addition, the specialized SBIC program focused on providing financing to small business entrepreneurs whose participation in the free enterprise system was hampered because of social or economic disadvantage. This program was repealed in 1996. Existing specialized SBICs were grandfathered into the SBIC program and a small number remain in operation. SBA also grants licenses to bank-owned SBICs—those fully owned by a bank—and nonleveraged SBICs, which do not receive program funding. For this report, we combined bank-owned and nonleveraged SBICs in one category and focused on SBICs that receive SBA leverage.

¹⁴Data for 2014 were the most recent available data at the time we conducted our analysis in 2015. Unless otherwise specified, years refer to fiscal years (October 1 of the prior year through September 30 of the following calendar year), and data refer to the end of the fiscal year (September 30 of the year cited). Unless otherwise noted, our analysis included only SBICs that were in operation—that is, under the jurisdiction of the Office of SBIC Operations—and not SBICs that had been transferred by SBA to the Office of SBIC Liquidation.

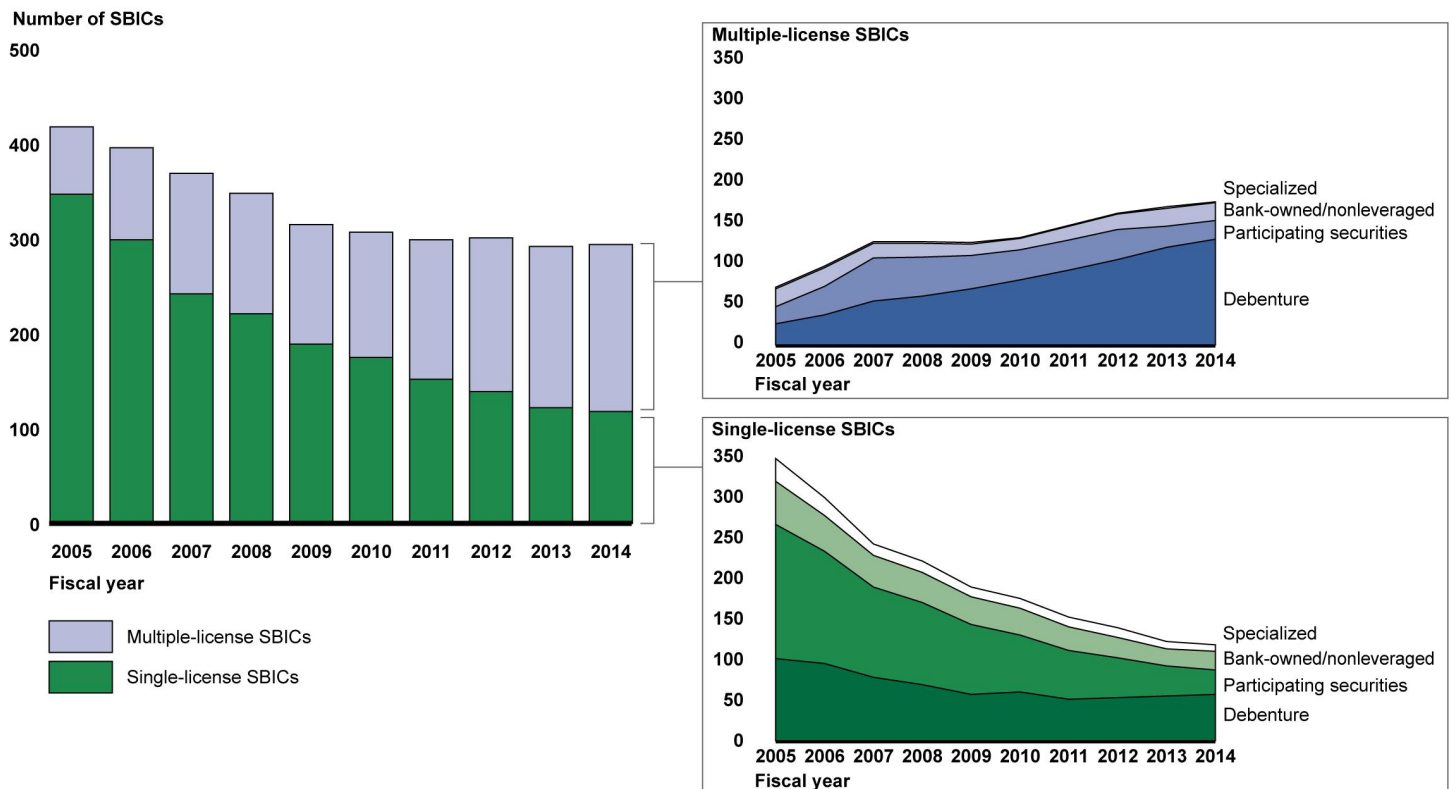
Figure 2: Number of Debenture Small Business Investment Companies (SBIC) and Licensees, as of the End of Fiscal Years 2005–2014



Source: GAO analysis of Small Business Administration data. | GAO-16-107

Although the number of debenture SBICs grew from 2005 through 2014, the number of SBICs overall—including participating securities SBICs, specialized SBICs, bank-owned SBICs, and nonleveraged SBICs—declined during that time frame (see fig. 3). This decrease was commensurate with the declining number of participating securities SBICs, the majority of which were managed by single licensees. SBA stopped issuing new commitments for participating securities after 2004, as noted earlier, and in each year since then several participating securities SBICs left the program.

Figure 3: Number of Small Business Investment Companies (SBIC), by License and by Type, as of the End of Fiscal Years 2005–2014



Nearly three-quarters of multiple-license SBICs in operation in 2014 were debtenture SBICs, compared with just under 50 percent of single-license SBICs (see table 1).

Table 1: Number of Small Business Investment Companies (SBIC), by Type, as of September 30, 2014

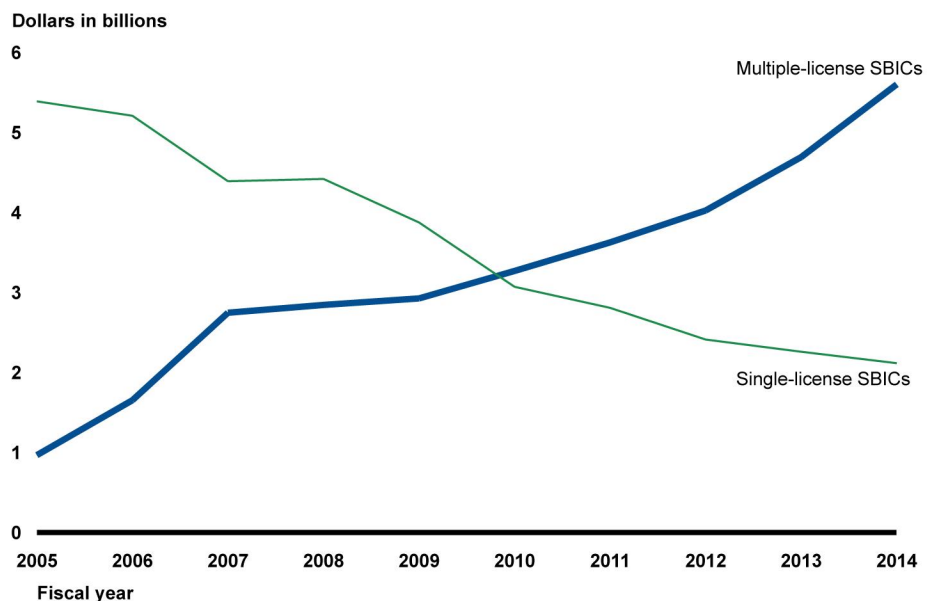
	Multiple-license SBICs		Single-license SBICs	
	Number of SBICs	Percentage of total	Number of SBICs	Percentage of total
Debenture	130	74%	57	48%
Participating securities	23	13	30	25
Specialized	1	1	8	7
Bank-owned/nonleveraged	22	13	23	19
Total	176		118	

Source: GAO analysis of Small Business Administration data. | GAO-16-107

Note: The percentages do not add up to 100 because of rounding.

For all SBIC fund types, the amount of SBA leverage held by multiple licensees increased every year from 2005 to 2014 but generally fell for single licensees (see fig. 4). This decline was commensurate with the phasing out of the participating securities program. In 2014, multiple licensees controlled nearly three-quarters of the leverage issued by SBA—multiple-license SBICs held more than \$5.6 billion in leverage and single-license SBICs held more than \$2.1 billion.

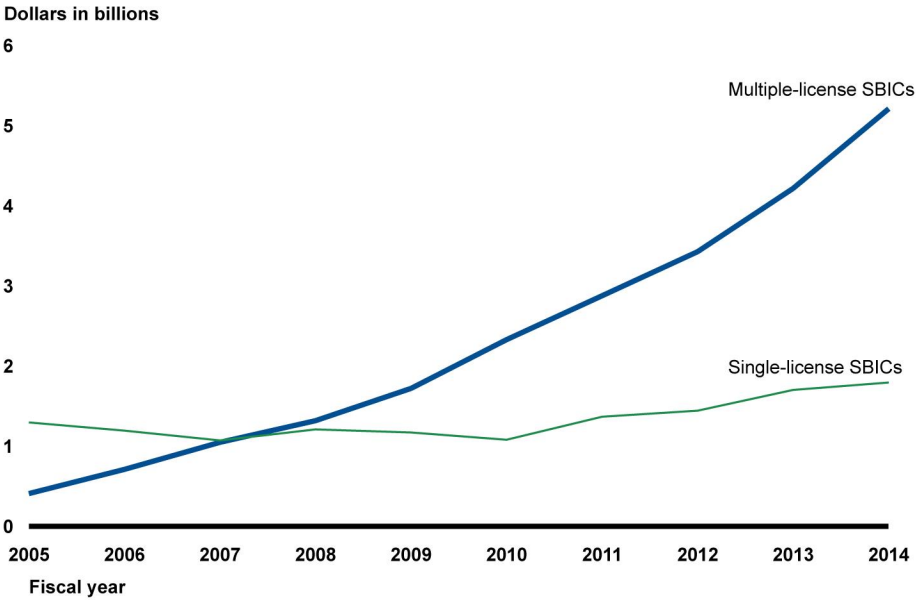
Figure 4: SBA Leverage Held by Small Business Investment Companies (SBIC), All Types, as of the End of Fiscal Years 2005–2014



Source: GAO analysis of Small Business Administration data. | GAO-16-107

For debenture SBICs specifically, multiple licensees also increased their share of total SBA leverage during 2005–2014 (see fig. 5). These SBICs held about 24 percent of SBA leverage in 2005, but about 74 percent of the approximately \$7 billion in SBA leverage in 2014.

Figure 5: SBA Leverage Held by Debenture Small Business Investment Companies (SBIC), as of the End of Fiscal Years 2005–2014



Source: GAO analysis of Small Business Administration data. | GAO-16-107

Few Multiple Licensees Used Allowable Maximum Leverage

During the period from 2009 to 2014, the maximum amount of SBA leverage available to multiple licensees was \$225 million, but few multiple licensees used, or approached, that amount.¹⁵ Our analysis of SBA data found that from 2009 to 2014, no more than 2.8 percent of multiple licensees reached the then-applicable \$225 million leverage limit—including

¹⁵The American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, increased the leverage limit for single licensees to the lesser of \$150 million or 300 percent of private capital and \$225 million for multiple licensees. § 505(a)(1), 123 Stat. at 156. Prior to 2009, the leverage limit was the same for both single and multiple licensees—although multiple licensees could obtain permission from SBA to exceed that limit—and was adjusted annually for inflation. In 2008, the leverage limit was \$137.1 million. The Consolidated Appropriations Act, 2016, raised the leverage limit for multiple licenses under common control to \$350 million. See Pub. L. No. 114-113, Div. E, tit. V, § 521(b) (amending 15 U.S.C. § 683(b)(2)(B)).

leverage drawn and SBA commitments—in any year.¹⁶ Moreover, few multiple licensees had come close to reaching the maximum amount in that period—for example, no more than 5.7 percent of multiple-license SBICs drew (or had commitments to draw) more than 85 percent of the leverage limit during this time frame. From 2005 to 2008, when the leverage limit for multiple licensees ranged from \$124.4 million to \$137.1 million, no more than 3.2 percent of multiple-license SBICs appeared to have reached the leverage limit (including commitments).¹⁷ The Small Business Investor Alliance and some SBIC fund managers told us they believed the leverage limit nonetheless has a significant effect because it deters some SBIC managers who want to substantially grow their fund over the long-term from continuing to participate in the program.

Single and Multiple Licensees Had Largely Similar Characteristics

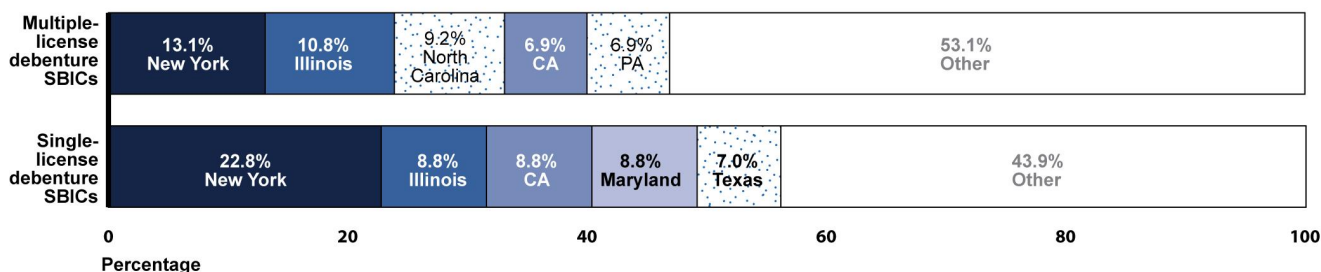
SBIC characteristics, including geographic distribution and management demographics, were largely similar for single and multiple licensees, according to our analysis. For example, although there were some differences in their concentrations among states, the extent of geographic distribution of multiple- and single-license debenture SBICs was roughly similar in 2014. Both types of SBICs were concentrated in several states in 2014 (see fig. 6), with the single-license debenture SBICs significantly more heavily concentrated in New York. Multiple-license debenture SBICs were located in more states (27) overall than single-license debenture SBICs (19) in 2014.¹⁸ Within states, both multiple- and single-license SBICs showed some concentrations in certain cities and regions in 2014—particularly New York City, Chicago, San Francisco, and the Silicon Valley area.

¹⁶SBA refers to the amount of leverage it issues as “leverage drawn.” An SBA commitment refers to a commitment by SBA to allow an SBIC to draw a certain amount of leverage in the future. Once approved, SBICs may request leverage draws up to the commitment amount for up to 4 years after the fiscal year in which the commitment was approved.

¹⁷We reviewed the total leverage balance for multiple-license SBICs every year from 2005 to 2014. Because the amount of SBA leverage held by an SBIC can change over the course of a fiscal year, it was not possible to determine the precise number of SBICs that had reached the leverage limit. However, SBA staff said they agreed with our finding that the number of SBICs that had reached the leverage limit was very small.

¹⁸Additionally, there was one single-license debenture SBIC in Washington, D.C. in 2014.

Figure 6: Distribution of Multiple- and Single-License Debenture Small Business Investment Companies (SBIC), by State, as of September 30, 2014



Source: GAO analysis of Small Business Administration data. | GAO-16-107

SBA does not routinely collect information on the number of minority or female SBIC managers or those SBICs located in low- or moderate-income areas, but at our request, the agency asked its operations analysts—who are responsible for overseeing and supporting a portfolio of SBICs—to provide estimates of these numbers for SBICs in their purview. SBA officials told us that because this was an informal survey, they could not make any representation about the completeness or accuracy of the information. Although the data have limitations, the survey showed the following characteristics among the 290 SBICs in operation as of July 2014:

- **Minority SBIC managers.** An estimated 10 percent or less of both multiple-license and single-license SBICs had at least one minority SBIC manager who was American Indian or Alaska Native, Asian, Black or African American, Hispanic or Latino, or Native Hawaiian or other Pacific Islander.
- **Female SBIC managers.** About 6 percent of multiple-license SBICs and 11 percent of single-license SBICs were estimated to have at least one female SBIC manager.

-
- **SBICs in low- or moderate-income areas.** Slightly more than 12 percent of both multiple- and single-license SBICs were estimated to be located in such areas.¹⁹

Multiple Licensees Have Outperformed Single Licensees but Their Investments Have Similar Attributes across a Number of Measures

Multiple licensees, in the aggregate, demonstrated better investment performance than single licensees from 2005 to 2014, according to our analysis. Despite some variation, for most other attributes there were not substantial differences between small businesses that received investments from multiple-license SBICs and those that received them from single-license SBICs. We could not report on minority, women, and veteran ownership of SBIC investments because the data were unreliable, in part because SBA does not provide guidance to SBIC licensees on how to collect and report this information.

Multiple Licensees Had Better Aggregate Investment Performance Than Single Licensees

In the aggregate, multiple-license SBICs demonstrated better investment performance than single-license SBICs during 2005 through 2014, according to our analysis. This trend was evident for SBICs overall and debenture SBICs specifically. We analyzed two measures of investment performance: (1) the rate at which SBICs were transferred to liquidation and (2) the estimated loss rate.²⁰ We also examined summary statistics

¹⁹SBA defines a low- or moderate-income area as any area located within a Historically Underutilized Business Zone (as defined in 13 C.F.R. § 126.103), an Urban Empowerment Zone or Urban Enterprise Community (as designated by the Secretary of Housing and Urban Development), a Rural Empowerment Zone or Rural Enterprise Community (as designated by the Secretary of Agriculture), an area of low income or moderate income (as recognized by the Federal Financial Institutions Examination Council), or a county with persistent poverty (as classified by the Economic Research Service of the Department of Agriculture). 13 C.F.R. § 107.50.

²⁰We analyzed investment performance in aggregate because looking at performance in a single year can be misleading, according to SBA staff, given that even successful SBICs see few returns in their first several years while the businesses in which they invest are maturing. SBA began collecting data in a manner that allowed isolating the performance of multiple and single licensees in 2005. We included in our analysis only SBICs in operation or liquidation as of the end of fiscal year 2005 and all SBICs licensed from that time through July 15, 2014.

provided by SBA on the number of SBICs that were capitally impaired while operating.²¹

Liquidation Rates

From September 30, 2005, to July 15, 2014, 20 percent of multiple-license SBICs were liquidated, compared with 57 percent of single-license SBICs (see table 2).²² Liquidation rates were highest for SBICs in the participating securities program. However, when considering only those in the debenture program, multiple-license SBICs also had much lower liquidation rates than single-license SBICs (6 percent and 39 percent, respectively). An SBIC can be liquidated when SBA assesses it to have excessive financial losses—that is, to be capitally impaired—or other regulatory violations, resulting in the oversight and responsibility of the SBIC being transferred from the Office of SBIC Operations to the Office of SBIC Liquidation. Once an SBIC is liquidated (which can result in the surrender, revocation, or suspension of the SBIC operating license), SBA says its primary goal is to maximize the net recovery of funds.

Table 2: Small Business Investment Companies (SBIC) Transferred to Liquidation, in Aggregate, from September 30, 2005, to July 15, 2014

	Multiple-license SBICs	Single-license SBICs
SBICs Overall	20%	57%
Debenture	6	39
Participating securities	49	69
Specialized	0	74

Source: GAO analysis of Small Business Administration data. | GAO-16-107

Estimated Loss Rate

According to SBA, the estimated loss rate for SBICs overall from September 30, 2005, to July 15, 2014, was 8.3 percent for multiple-

²¹An SBIC is considered capitally impaired when its investment and operating losses relative to its private capital exceed the maximum allowable capital impairment percentage.

²²For this analysis, the denominator is the total number of licensed SBICs from September 30, 2005, to July 15, 2014, that were issued leverage, including those in liquidation, on September 30, 2005.

license SBICs and 21.3 percent for single-license SBICs (see table 3).²³ For debenture SBICs in particular, this loss rate was approximately 3.7 percent and 10.6 percent for multiple-license and single-license SBICs, respectively. The estimated loss rate refers to anticipated ultimate losses divided by the sum of SBA leverage redeemed in operations, leverage transferred to liquidation, and draws in liquidation.²⁴ SBA estimates how much an SBIC in liquidation will be unable to repay based on both financial losses that have occurred and anticipated losses.

Table 3: Estimated Loss Rates for Small Business Investment Companies (SBIC), Aggregated, from September 30, 2005, to July 15, 2014

SBIC type	Anticipated Ultimate Losses ^a (millions of dollars)	Estimated loss rate ^b (percentages)
Multiple-license SBICs	\$539	8.3%
Debenture	111	3.7
Participating securities	428	12.4
Specialized	0	0.0
Single-license SBICs	\$1,757	21.3%
Debenture	201	10.6
Participating securities	1,508	24.3
Specialized	48	31.7

Source: GAO analysis of Small Business Administration data. | GAO-16-107

^aAnticipated ultimate losses represent actual charge-offs (the leverage SBA determines it will not be able to recover) and anticipated future losses as estimated by the Office of Liquidation each year.

^bThe estimated loss rate represents anticipated ultimate losses divided by the sum of SBA leverage redeemed in operations, leverage transferred to liquidation, and draws in liquidation.

Capital Impairment

During most points in time from calendar years 2005 through 2014, more single-license SBICs than multiple-license SBICs experienced capital

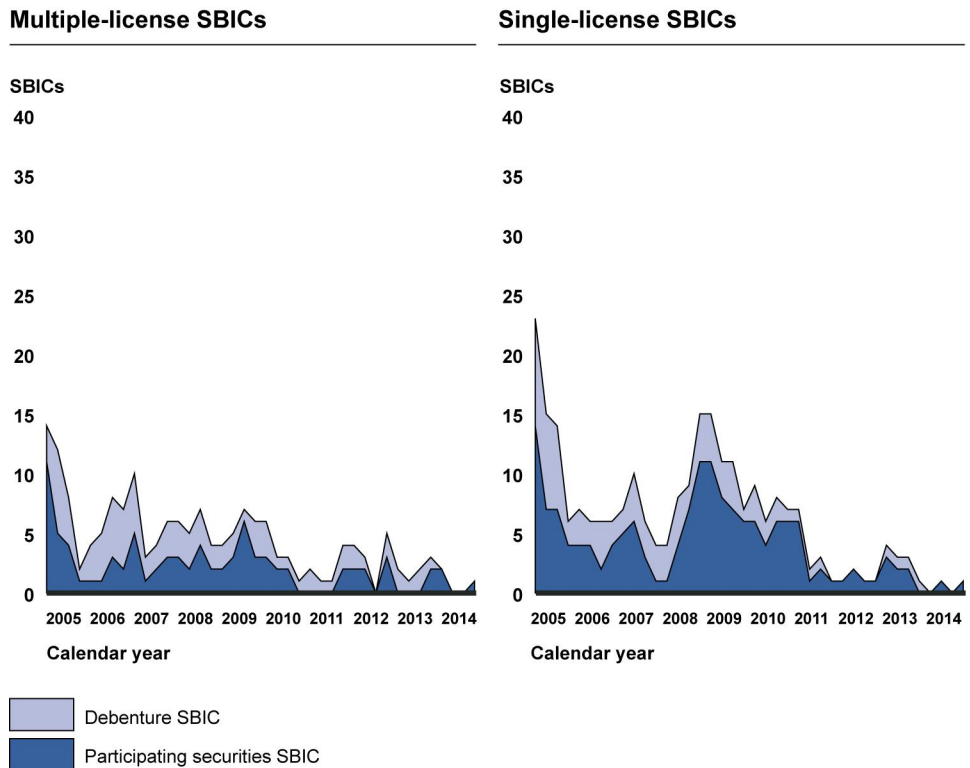
²³The estimated loss rate is a performance measure specifically prepared by SBA at our request for comparing the financial performance of single- and multiple-license SBICs. The data used in this analysis do not include projected losses on outstanding leverage to SBICs in operation. According to SBA, the estimated loss rate is an appropriate measure for comparing the investment performance of single- and multiple-license SBICs.

²⁴Anticipated ultimate losses represent actual charge-offs (the leverage SBA determines it will not be able to recover) and anticipated future losses as estimated by the Office of Liquidation each year.

impairment at some point in their operation. An SBIC is considered capitalily impaired when its investment and operating losses relative to its private capital exceed the maximum allowable capital impairment percentage.²⁵ SBA states that capital impairment is the primary factor it uses to assess whether an SBIC should be liquidated. SBICs that are capitalily impaired can be transferred to liquidation or be allowed to continue active operation. As seen in figure 7, the number of SBICs in active operation that were capitalily impaired generally declined from 2005 to 2014, and most capitalily impaired SBICs were in the participating securities program.

²⁵The maximum permitted levels of the capital impairment percentage are detailed in the regulations and vary depending on the proportion of equity investments made by the SBIC. For Section 301(c) licensees, which were the majority of SBICs as of September 30, 2014, the maximum permitted capital impairment percentage ranges between 70 percent and 35 percent, depending on the percentage of equity capital investments in the licensee's portfolio. For Section 301(d) licensees (also referred to as specialized SBICs), the maximum permitted capital impairment percentage is 75 percent. See 13 C.F.R. § 107.1830(c).

Figure 7: Number of Small Business Investment Companies (SBIC) in Capital Impairment, by Type and by Quarter, Calendar Years 2005–2014



Source: GAO analysis of Small Business Administration data. | GAO-16-107

Note: An SBIC that was capital impaired in one quarter may not stay capital impaired in the subsequent quarter(s).

SBA staff, SBIC managers, and industry participants with whom we spoke cited several reasons why multiple licensees performed better, in the aggregate, than single licensees. First, they said that multiple-license fund managers generally are more experienced and have experience operating an SBIC fund. Second, SBA and some industry participants said that multiple-license SBICs already have demonstrated success because approval of a subsequent SBIC license is largely based on the financial performance, operating history, and managerial track record of the existing SBIC fund. Finally, they said that multiple-license SBICs are often larger than single-license SBICs, with investments in a greater number of small businesses. Having more investments reduces exposure to financial risk if one investment performs poorly. Larger SBICs also may have greater staff capacity than smaller SBICs, and may be able to provide more technical assistance to their small businesses. Nonetheless,

SBA staff noted that while these factors may help explain differences in performance in the aggregate, single licensees and multiple licensees can both perform successfully. In addition, SBA staff and an industry participant told us that an SBIC's age can affect performance—for example, young SBICs that have just begun developing their businesses are unlikely to be transferred to liquidation. However, our analysis found that there was not a substantial difference in the average age of multiple- and single-license SBICs—9.0 and 10.2 years respectively—during the aggregate period 2005 through 2014.²⁶

Multiple- and Single-License SBICs Invest in Small Businesses with Roughly Similar Attributes

SBICs invest in a variety of small businesses, although to some extent statutory and regulatory requirements govern these investments, as noted earlier.²⁷ We reviewed the number and amount of multiple- and single-license SBIC investments in small businesses, as well as characteristics of the small businesses receiving the investments. Despite some variation, for most attributes, we did not find substantial differences between small businesses that received investments from multiple-license SBICs and those that received them from single-license SBICs.

Number and Trends of Investments

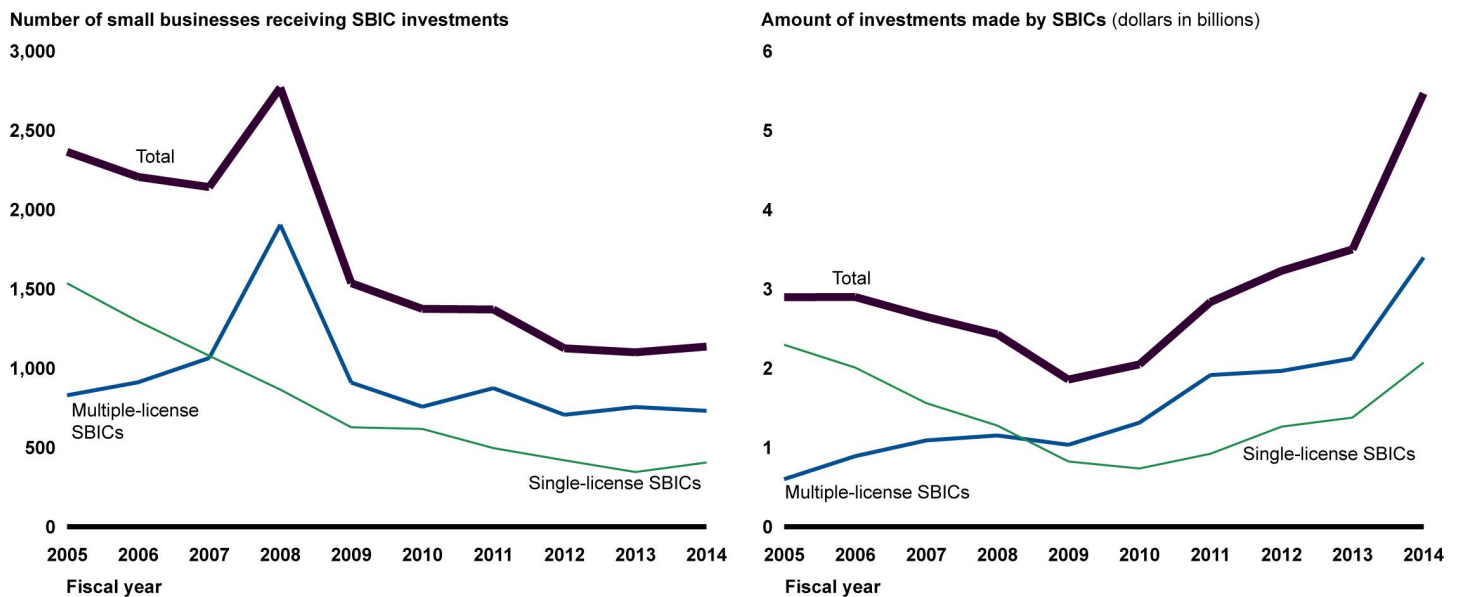
As of September 30, 2014, SBICs invested in 1,085 small businesses. Multiple-license SBICs invested in 731 businesses and single-license SBICs in 405 businesses.²⁸ These investments totaled about \$5.5 billion, of which multiple-license SBICs made about \$3.4 billion and single-license about \$2.1 billion. The total number of small businesses receiving SBIC investments largely decreased from 2005 to 2014, but the dollar amount of total investments made in that period generally increased (see fig. 8).

²⁶These numbers represent the 10-year average of each year's average age for multiple- and single-license SBICs.

²⁷See 15 U.S.C. §§ 684-685; 13 C.F.R. pt. 107.

²⁸The sum of small business investments made by single- and multiple-license SBICs (1,136) is greater than the number of small businesses receiving investment (1,085) because in some cases different SBICs invested in the same small business.

Figure 8: Number and Dollar Amount of Small Business Investment Company (SBIC) Investments to Small Businesses, as of the End of Fiscal Years 2005–2014



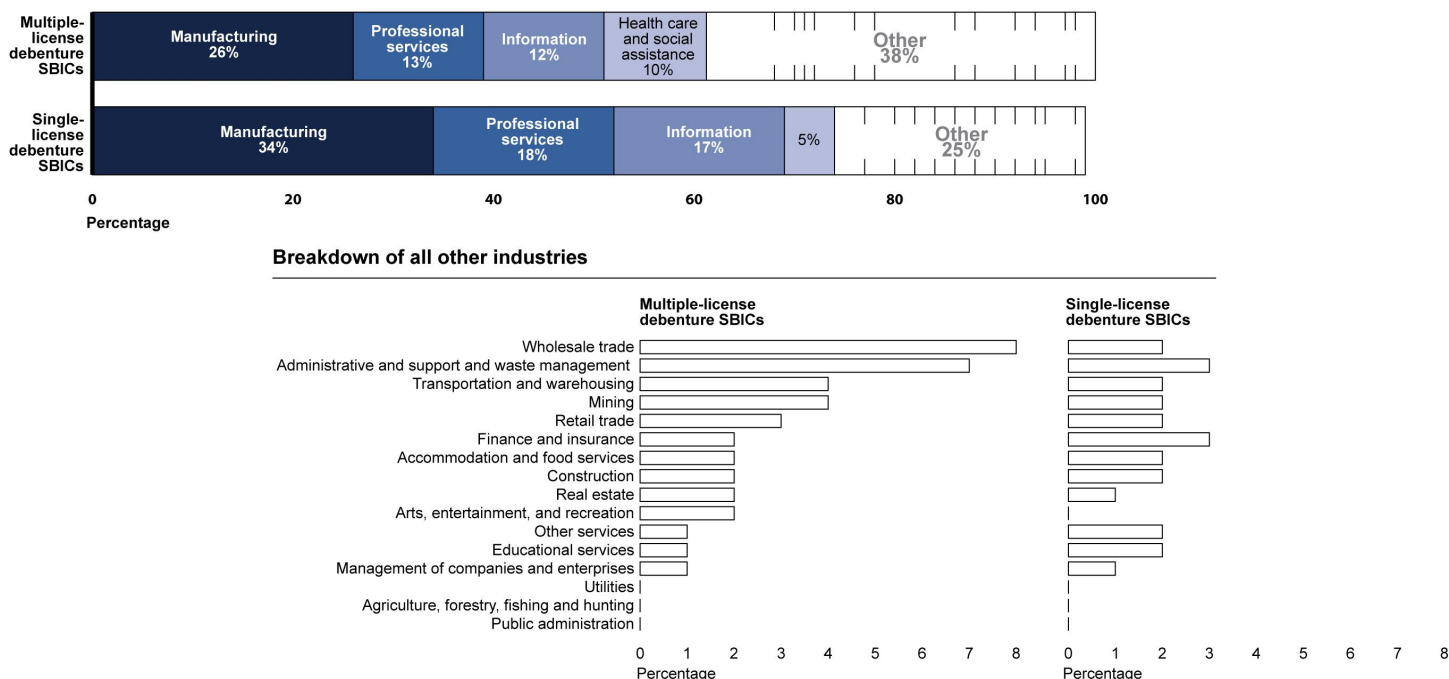
Source: GAO analysis of Small Business Administration data. | GAO-16-107

Industry Types

Multiple- and single-license SBICs invested in small businesses representing a range of industries in 2014. According to SBIC fund managers, some SBICs specialize in a particular field or industry in which their management has expertise, and others invest more generally. While there was some variation, multiple and single licensees made the majority of their investments in four industry areas—manufacturing, professional services, information, and health care and social assistance (see fig. 9).²⁹ Among the smaller industries represented, multiple licensees had a larger proportion than single licensees of investments in wholesale trade (8 percent versus 2 percent) and administrative and support and waste management (7 percent versus 3 percent).

²⁹Federal agencies use the North American Industry Classification System to assign industry classification codes designating businesses' main industry and line of business.

Figure 9: Industry Categories for Small Businesses Receiving Small Business Investment Company (SBIC) Investments, as of September 30, 2014



Source: GAO analysis of Small Business Administration data. | GAO-16-107

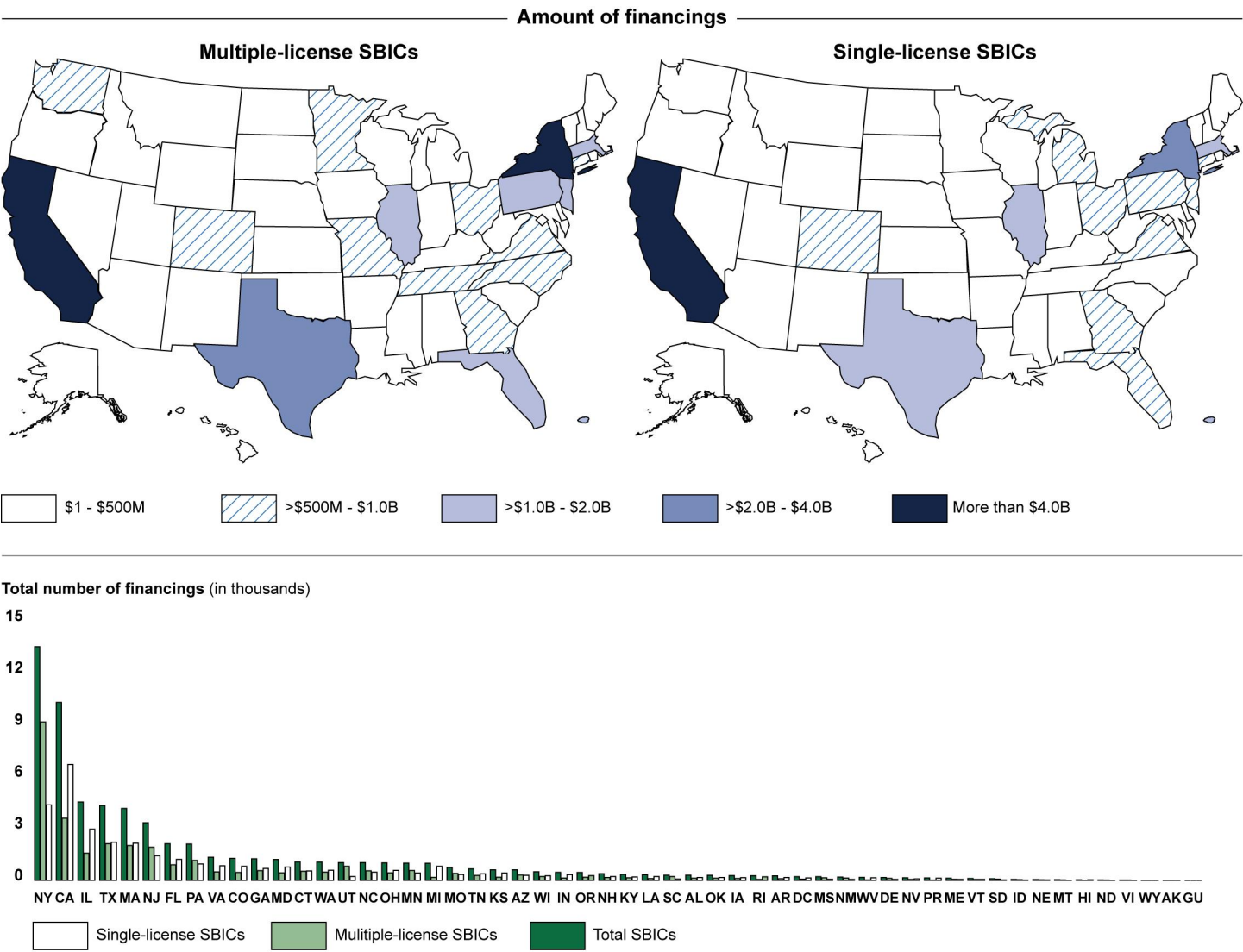
Geographic Distribution of Investments

All 50 states, Washington, D.C., Puerto Rico, and the Virgin Islands received SBIC investments from multiple- and single-license SBICs from October 1989 to June 2014, although the investments were largely concentrated in several of the more populous states (see fig. 10), according to our analysis.³⁰ In dollar terms, multiple-license SBICs had the most investment in California, followed by New York, Texas, Massachusetts, and Florida. Collectively, these states accounted for nearly half of all multiple-license SBIC investment. Single-license SBIC investments were similarly concentrated, with nearly half of their investment going to small businesses in California, New York, Texas, Illinois, and Massachusetts.

³⁰Our analysis covers October 1989 to June 2014 because that is the time frame of the data provided to us by SBA related to geographic distribution of SBIC investments. It represents distribution of investments made during that time frame for SBICs that were in active operation or liquidation as of September 30, 2005, and those SBICs licensed from that time to July 15, 2014.

From October 1989 to June 2014, 26 states, Washington, D.C., Puerto Rico, and the Virgin Islands each received less than 1 percent of SBIC investment, in dollar terms, from multiple- and single-license SBICs.

Figure 10: Geographic Distribution for Small Businesses Receiving Small Business Investment Company (SBIC) Investments, from October 1989 to June 2014



Investments in Low- or
Moderate-Income Areas and to
Smaller Enterprises

Multiple-license and single-license SBICs placed similar proportions of their total dollar investments—about 19 percent and 18 percent, respectively—in small businesses in low- or moderate-income areas in 2014, according to our analysis. In 1999, SBA introduced the low- or moderate-income debenture to encourage SBICs to invest in small businesses in inner cities and rural areas that have severe shortages of equity capital.³¹ The low- or moderate-income debenture provides incentives to SBICs that invest in small businesses that have at least 50 percent of their employees or tangible assets in a low- or moderate-income area or have at least 35 percent of their full-time employees with a primary residence in such an area. It differs from the standard SBA-guaranteed debenture in that it is issued at a discount and requires no interest payments or fees for the first 5 years.

Multiple licensees were slightly more likely than single licensees to have more than half of their investments in “smaller enterprises.” From September 30, 2005, to July 15, 2014, our analysis found that 84 percent of multiple licensees had more than half their investments in smaller enterprises, compared with 73 percent of single licensees.³² SBICs must invest a percentage of financings in such enterprises, which are generally defined as businesses with a net worth of no more than \$6 million and average after-tax net income of no more than \$2 million.³³

³¹Small Business Investment Companies, 64 Fed. Reg. 52641 (Sept. 30, 1999) (amending 13 C.F.R. § 107.50 and implementing 13 C.F.R. § 107.610).

³²SBA was able to provide us with data on investments in smaller enterprises for 501 of the 538 SBIC licensees in operation or liquidations as of the end of fiscal year 2005 and all SBICs licensed from that time through July 15, 2014.

³³A smaller enterprise has a net worth of not more than \$6 million and average after-tax net income for the prior 2 years of less than \$2 million or another amount that meets an alternative test specified by regulation. 13 C.F.R. § 107.710. SBICs licensed after February 17, 2009, must invest at least 25 percent of their financings in smaller enterprises. 13 C.F.R. § 107.710(b)(1).

Data on Minority, Women, and Veteran Ownership of SBIC Investments Are Not Reliable

As part of the required Form 1031, SBIC licensees can voluntarily report data on the percentages of minority, women, and veteran ownership of the small businesses in which they invest.³⁴ Using these data, SBA reported in the 2014 SBIC annual report that SBICs financed 70 small businesses owned by women, minorities, or veterans in 2014, which would represent about 6 percent of all businesses in which SBICs invested.³⁵

However, our review raised questions about the reliability of these data. The reporting is voluntary, and a portion of licensees choose not to respond.³⁶ It was not possible for us to determine the reporting response rate—that is, the proportion of licensees that provided the data—because of the design of the questionnaire and inconsistencies in how certain questions were answered. For example, it was not clear if a blank response to a question on minority-owned investments was intended to indicate zero investment or a nonresponse. SBA does not provide guidance to SBIC licensees on how to collect and report these data, and thus there is no uniform process for doing so. SBIC managers told us that they collect these data through various methods, such as by specifically asking their small businesses to report whether they are owned by women, minorities, or veterans, or by providing an estimate based on their personal knowledge and observation. In addition, SBA staff told us

³⁴SBICs must submit the Portfolio Financing Report, Form 1031, within 30 days of investing in a small business. 13 C.F.R. § 107.640. SBA uses the form to track various aspects of SBIC program financing to small businesses.

³⁵Small Business Administration, *The Small Business Investment Company Program (SBIC), Annual Report Fiscal Year 2014*. In addition, the Congressional Research Service used data provided by SBA to provide additional breakdowns of the data, which, as discussed later in this report, were not sufficiently reliable for our reporting purposes. Congressional Research Service, *SBA Small Business Investment Company Program*, R41456 (Washington, D.C.: July 14, 2015). SBA defines minorities as individuals who are American Indian or Alaska Native, Asian, Black or African American, Hispanic or Latino, or Native Hawaiian or other Pacific Islander.

³⁶SBA officials told us that the Small Business Investment Act of 1958 may give the agency the authority to collect demographic information on a voluntary basis but not to require SBICs to collect and report such data. The agency could require reporting of such information as a condition of retaining program benefits, officials said, only if the agency needed it to assess program participants' compliance with statutory or regulatory criteria governing core program requirements, or to make licensing decisions. SBA officials told us their position was that demographic information was not necessary for program participation and that the agency could not require respondents to report such information because SBA did not have authority to assess compliance based on race, ethnicity, or gender factors.

the demographic questions on Form 1031 can be challenging for licensees to answer because small businesses receiving SBIC investments can have complex ownership structures—such as parent companies or partnerships—that would make identification of minority, women, and veteran ownership difficult. SBA staff told us they do not provide guidance on these questions because when the form was created, SBA believed the questions were self-explanatory, and subsequently it has not received inquiries from licensees requesting further explanation.

More reliable data in this area would be consistent with SBA's strategic plan, which cites as a strategic priority of the SBIC program expanding access to financial capital for minority-, women-, and veteran-owned small businesses.³⁷ In its submission to the Office of Management and Budget requesting approval of the collection of information contained in Form 1031, SBA supported its request by stating that questions about the ethnicity and gender of portfolio company owners and top managers were used to evaluate the program's contribution to furthering the growth of small business in historically underserved communities. Specific guidance to SBIC licensees on providing voluntary demographic data on their investments could help clarify how to define minority-, women-, and veteran-owned businesses. In addition, such guidance could help improve response rates and help ensure the consistency of these data, providing useful information in support of SBIC program goals.

³⁷Small Business Administration, *FY 2014–2018 Strategic Plan* (Washington, D.C.: 2014).

Recent SBIC Program Performance Has Been Relatively Stable and the Program Includes Oversight Measures Intended to Manage Risk

Financial losses in the SBIC program rose significantly in the early 2000s, generally declined in the mid-2000s, and have been relatively stable since then. The participating securities program, which was created by statute, accounted for the majority of losses.³⁸ The degree to which the SBIC program's performance can be attributed to SBA oversight is uncertain, but several statutory requirements, regulations, and oversight mechanisms—including licensing procedures, examinations, and liquidation and asset recovery—seek to manage financial risk. The requirements and procedures for approving and overseeing multiple licensees are largely the same as for approving single licensees.

Program Loss Rates Were Generally Stable in Recent Years

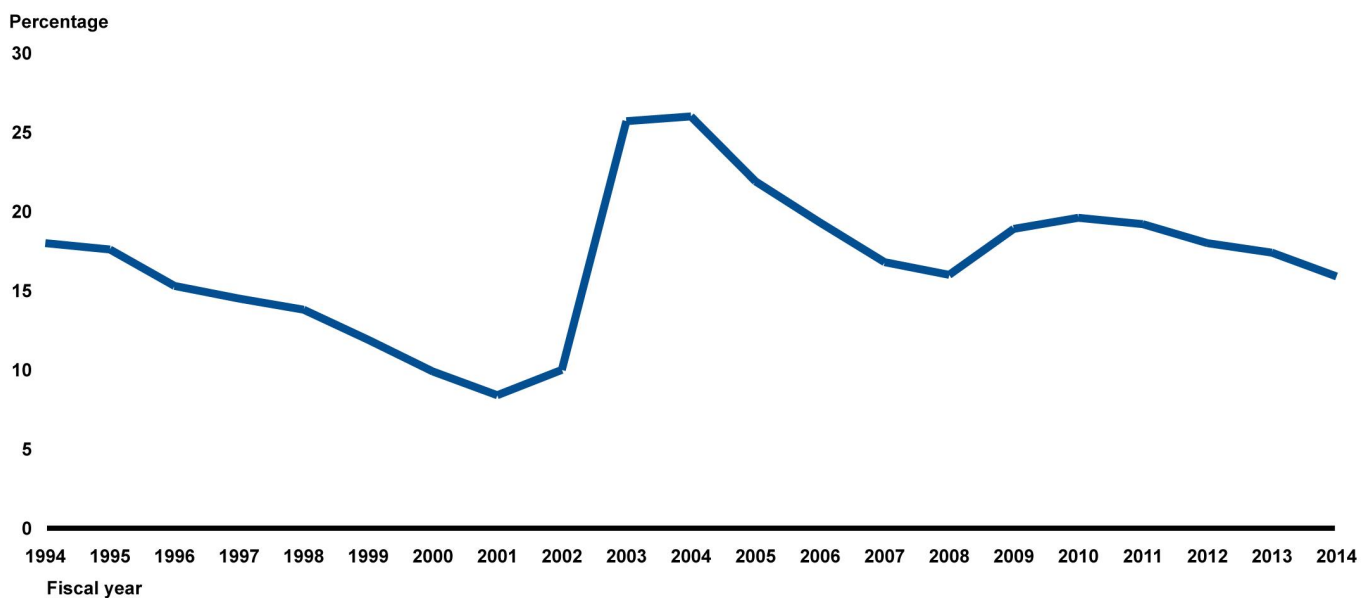
The ultimate loss rate for the overall SBIC program fluctuated from 1994 to 2014 but has been relatively stable since about 2006, according to SBA data.³⁹ As shown in figure 11, the loss rate declined from 1994 to 2001 and then increased sharply between 2001 and 2004, according to SBA's Ultimate Loss Reports.⁴⁰ Losses then began to decline and have remained relatively stable since 2006.

³⁸Small Business Credit and Business Opportunity Enhancement Act of 1992, Pub. L. No.102-366, § 403, 106 Stat. 986, 1009 (codified at 15 U.S.C. § 683(g)).

³⁹The ultimate loss rate represents the actual and projected losses that SBA estimates will not be repaid divided by the total amount of SBA leverage that SBICs have drawn.

⁴⁰The Ultimate Loss Report documents summary statistics from SBA's estimates of the anticipated future recovery of leverage in liquidation, anticipated ultimate losses (including charge-offs and anticipated future losses), and the ultimate loss rate for the SBIC program overall and by program type, as of the end of each fiscal year.

Figure 11: Small Business Investment Company Program: Ultimate Loss Rate, End of Fiscal Years 1994–2014



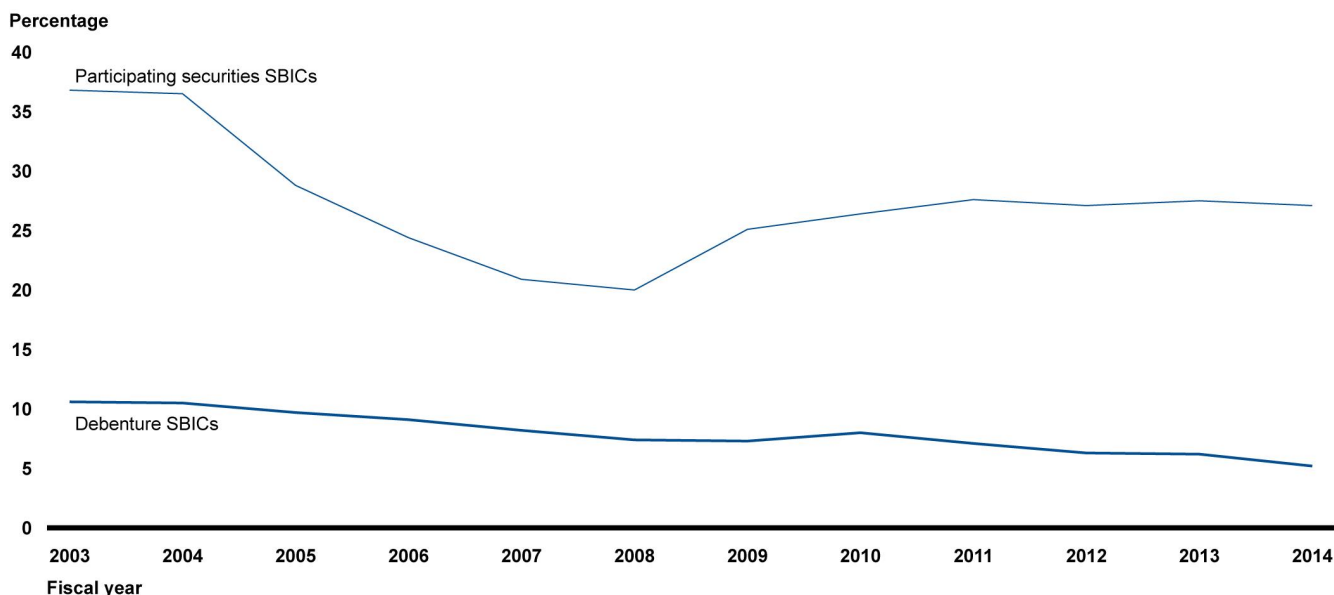
Source: Small Business Administration. | GAO-16-107

The participating securities SBICs had a much higher ultimate loss rate than debenture SBICs from 2003 to 2014 (see fig. 12).⁴¹ As discussed earlier in this report, SBA stopped issuing new leverage commitments for participating securities SBICs after 2004 due to high losses, but existing SBICs created under that program could continue to operate, with 53 still in operation as of the end of 2014. Loss rates of the debenture program (which accounted for most outstanding SBIC leverage) steadily declined from 2003 to 2014. By 2014, the loss rate for participating securities SBICs was about 27 percent, compared with 5 percent for debenture SBICs.⁴²

⁴¹SBA did not begin to report the ultimate loss rates of the different types of SBICs until 2003.

⁴²In addition, as of the end of 2014, nine specialized SBICs remained in operation.

Figure 12: Small Business Investment Company (SBIC) Program: Ultimate Loss Rate for Debenture and Participating Securities SBICs, End of Fiscal Years 2003–2014



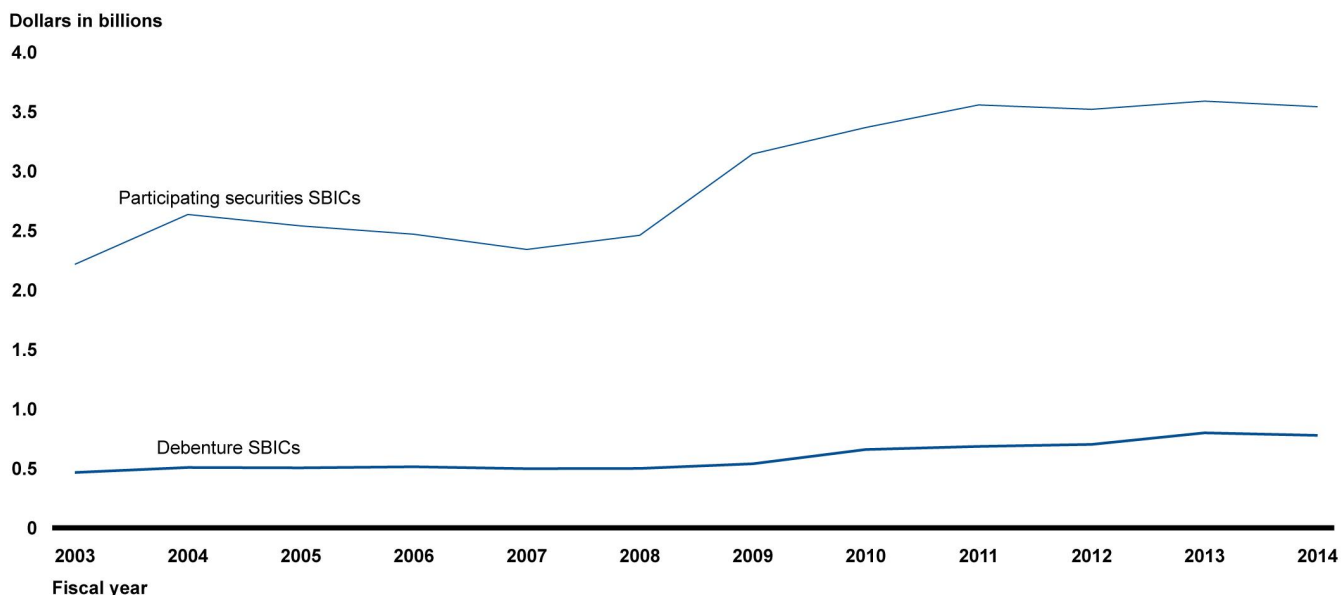
Source: Small Business Administration. | GAO-16-107

Correspondingly, participating securities SBICs generated the majority of the program’s ultimate losses in dollar terms from 2003 to 2014 (see fig. 13).⁴³ As of the end of 2014, participating securities SBICs accounted for about 77 percent of the ultimate losses for the overall SBIC program, although they represented 9 percent of outstanding SBIC leverage. Ultimate losses for these SBICs totaled \$3.5 billion, while losses for debenture SBICs were about \$778 million.⁴⁴

⁴³According to SBA, ultimate losses in dollar terms for a given year represent the cumulative financial losses, as of the end of that year, of all the SBICs that have participated in the SBIC program since its inception in 1958.

⁴⁴In addition, ultimate losses for specialized SBICs were \$274 million as of the end of 2014.

Figure 13: Small Business Investment Company (SBIC) Program: Cumulative Ultimate Losses, by Type of SBIC, End of Fiscal Years 2003–2014



Source: Small Business Administration. | GAO-16-107

SBA has said that the financial performance of the SBIC program generally has been comparable with the private equity industry. According to SBA's 2014 SBIC annual report (the most recent available), SBA benchmarked the performance of debenture SBICs—licensed in calendar years 1998 through 2014—to several industry indexes, such as the Preqin Private Equity Index and the S&P 500 Index.⁴⁵ SBA conducted the benchmark analysis using several metrics, including the historical rate of return of these SBICs over a number of years. SBA reported that the performance

⁴⁵Small Business Administration, *The Small Business Investment Company Program (SBIC), Annual Report Fiscal Year 2014*. The Preqin Private Equity Index measures the performance of private equity funds—privately managed investment pools administered by professional managers, who typically make long-term investments in private companies, taking a controlling interest with the aim of increasing the value of these companies. The S&P 500 Index is an index that includes 500 leading companies and captures approximately 80 percent coverage of available market capitalization and is widely used as a gauge of large-cap U.S. equities. According to SBA, the agency selected these indexes because they were readily available and typically used by the private equity industry as performance benchmarks.

of debenture SBICs was comparable with the performance of the private equity industry and that they had outperformed several equity market indexes in the 5 years from 2010 to 2014.

Congress required the SBIC program to be self-funded (that is, operate at zero subsidy cost) for any financings issued starting in 2001.⁴⁶ Each year, as part of its budget process, SBA forecasts expected SBIC program losses and sets fees accordingly to cover the expected losses for financing approved during that budget year.⁴⁷ SBA annually estimates the program's subsidy costs as required by the Federal Credit Reform Act of 1990, using historical information and various assumptions about such things as the fees paid by SBICs, interest income paid on SBIC financings, recoveries, and default rates.⁴⁸ SBA also incorporates economic assumptions in the President's Budget into its estimates, although SBA staff told us they do not incorporate economic factors that are forward-looking, such as projected macroeconomic conditions.

In addition, the Federal Credit Reform Act of 1990 requires agencies to annually reestimate the credit subsidy cost because estimates of credit subsidy can change over time. These reestimates reflect any changes in actual performance of the SBIC program since the estimates were

⁴⁶Small Business Reauthorization Act of 2000, Pub. L. No. 106-554, § 404, 114 Stat. 2763A-667, 2763A-690-691.

⁴⁷SBA generally does not receive annual appropriations for the SBIC program beyond funds for salaries and related administrative expenses. As noted earlier, SBA charges SBICs different types of fees, including the annual charge, which in 2015 was 0.742 percent on the outstanding leverage balance. SBA has the authority to determine the amount of the annual charge on the outstanding amount of SBA leverage issued, although by law it cannot exceed 1.38 percent. 15 U.S.C. § 683(b).

⁴⁸The Federal Credit Reform Act of 1990 was enacted as part of the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, tit. XIII, subtit. B, § 13201, 104 Stat. 1388. An agency program has a positive subsidy when estimated payments by the agency exceed estimated payments from the program participants, on a net present value basis over the life of the financing. Conversely, the program has a negative subsidy when such payments from program participants exceed payments by the agency. A program with positive subsidy costs requires appropriations, while a program with negative subsidy costs is expected to produce income to the government. The credit subsidy cost does not include administrative costs. SBA's credit subsidy costs and reestimates, including those for the SBIC program, are annually audited by an external auditor for accuracy and reviewed and approved by the Office of Management and Budget for their consistency with guidance and proper methodologies used. The auditor did not report any findings on SBA's credit subsidy model in the agency's 2014 financial report. SBA staff stated that the auditor has never reported any issues with the credit subsidy calculation for the SBIC program.

prepared, as well as any expected changes in assumptions related to future performance of the program. From 1994 through 2014, SBA's reestimates for the debenture program generally have been favorable—that is, they showed a lower estimated cost to the government than the original estimate—while reestimates for the participating securities program generally have been unfavorable.⁴⁹

SBIC Program Includes Oversight Processes and Regulatory Requirements Intended to Manage Risk

Several statutory requirements, regulations, and oversight mechanisms are designed to manage the financial risk presented by the SBIC program. These include or derive from the Small Business Investment Act of 1958, its implementing regulations, SBIC standard operating procedures, and other processes and mechanisms.⁵⁰ Oversight mechanisms intended to manage risk include the application and licensing processes, market validation, reporting requirements and risk assessments, examinations, and liquidation and asset recovery.⁵¹ SBA's oversight affects the financial performance of the SBIC program, although its effect can be difficult to measure because factors such as economic conditions and program design also affect program performance.

Application and Licensing Processes

According to SBA, applicant screening, which occurs through the application and licensing processes, is a key mechanism for managing program risk. As seen in figure 14, application and licensing is a two-phase process. For the first phase, SBA offers an optional prescreening process designed to help prospective applicants determine whether they should formally apply for a license. First-time applicants that proceed must submit a management assessment questionnaire in which they provide a description of their proposed investment strategy, detailed investment track records of the fund management team, references, and

⁴⁹When reestimated credit subsidy costs exceed agencies' original credit subsidy cost estimates, the additional subsidy costs are not covered by new appropriations but rather are funded from permanent, indefinite budget authority.

⁵⁰See Pub. L. No. 85-699, 72 Stat. 689 (codified as amended at 15 U.S.C. §§ 661-697g) and 13 C.F.R. pt. 107. While regulations provide the rules that govern SBICs, SBA issues standard operating procedures to describe how the SBIC program is administered and additional guidance to provide further clarification on specific areas and special topics.

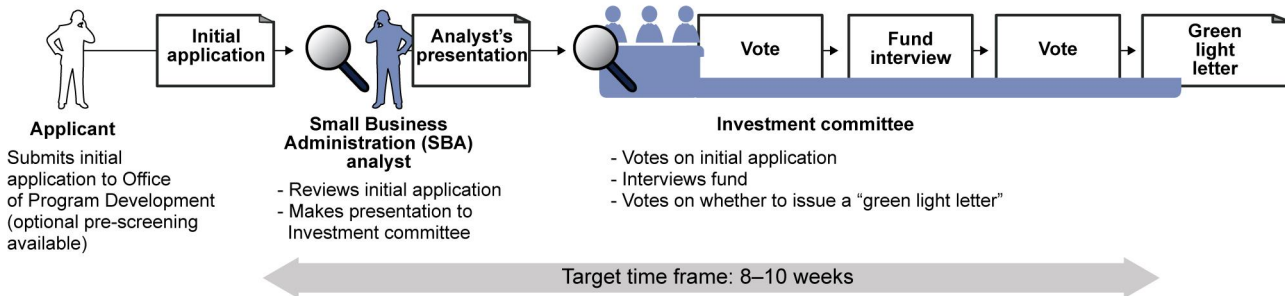
⁵¹Our description of key risk management activities is based largely on SBA documentation, such as its standard operating procedures, and interviews with SBA staff. Although we corroborated some of this information with external sources, we did not verify SBA's compliance with its own policies and procedures as part of the scope of our review.

other information. An SBA analyst reviews the questionnaires and contacts references to verify the accuracy of the information. The process is intended to help assess the applicant's character, reputation, and capability to invest in eligible small businesses.⁵² Next, the SBA analyst prepares an "investment memorandum" with a recommendation to SBA's Investment Committee stating whether the applicant's management team appears to have the minimum qualifications to manage the proposed SBIC. On the basis of the information provided in the memorandum, the Investment Committee decides whether to invite the applicant to an interview.

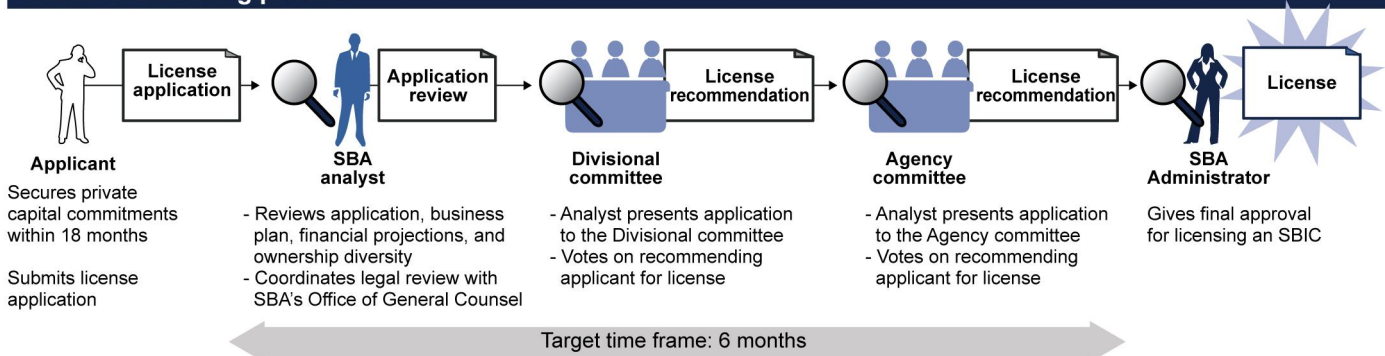
⁵²Small Business Administration, *Standard Operating Procedure, Processing Applications for SBIC Licenses*, SOP 10 04 01 (Washington, D.C.: Aug. 6, 2014).

Figure 14: Application and Licensing Process for Small Business Investment Company (SBIC) Program

Phase 1: Application process



Phase 2: Licensing process



Source: GAO. | GAO-16-107

Note: The Investment Committee, Divisional Committee, and Agency Committee each consist of several senior managers of the SBIC program. In addition, while this figure describes SBA's application and licensing processes, we did not examine SBA's compliance with these processes.

Following the interview, the committee decides whether to formally invite the applicant to file a license application once the applicant has raised the required minimum amount of private capital. Applicants that succeed in raising sufficient private capital within 18 months are permitted to submit a formal application for an SBIC license. Section 301(c) of the Small Business Investment Act also requires SBA to consider (1) whether the applicant is qualified and has the knowledge, experience, and capability necessary to comply with the act; and (2) the need for and availability of financing for small businesses in the geographic areas in which the

applicant plans to invest, among other things.⁵³ SBA’s licensing procedures state that SBA looks for teams with at least two principals who have substantial investment experience and the probability of successful operations. In addition, SBA’s procedures state that the agency looks for a cohesive management team with complementary skills and a history of working together.

SBA staff told us that since the mid-1990s the agency made a number of changes to raise the standards for receiving an SBIC license, placing greater emphasis on the background and expertise of the prospective licensee to attract more experienced applicants. They said these changes contributed to significant improvements in the SBIC program and a reduction in the number of SBIC defaults. Industry participants with whom we spoke generally agreed with this assessment, noting that in recent years SBA had set higher standards for approving SBIC management teams and investment strategies. According to SBA, from 2010 through 2014, the agency approved approximately 50 percent of entities applying for the first time for an SBIC license.

Market Validation

According to SBA’s licensing procedures, once formally invited to apply for an SBIC license, applicants are given 18 months to raise sufficient private capital. The applicant’s ability to raise sufficient private capital serves as a “market validation” mechanism that manages risk, according to SBA officials, SBIC fund managers, and industry participants. SBIC fund managers with whom we spoke said that a fund manager’s ability to raise private capital demonstrated the market’s assessment that the fund manager was competent and likely to operate the SBIC profitably. By statute, SBIC applicants must raise at least \$5 million in capital from private investors.⁵⁴ However, SBIC fund managers told us that in recent years, SBA generally expected applicants to raise an amount in excess of the statutory minimum (generally more than \$20 million) to be approved for a license.

Reporting Requirements and Risk Assessments

By regulation, SBICs must submit quarterly and annual financial statements.⁵⁵ Agency guidelines direct SBA financial analysts to use the statements to assess the SBIC’s investment risk, continued eligibility for leverage, compliance with regulatory requirements, and financial

⁵³Pub. L. No. 85-699, § 301(c)(3), 72 Stat. 689, 691 (codified as amended at 15 U.S.C. § 681(c)(3)).

⁵⁴15 U.S.C. § 682(a)(1)(A).

⁵⁵13 C.F.R. §§ 107.630 and 107.1220.

performance. An SBIC's annual financial statement includes information on its investment portfolios, regulatory capital, SBA leverage balance, and any management changes. As part of the annual statements, SBIC licensees also must provide SBA with an assessment of the impact of each small business investment, including number of employees, revenue and profits, and taxes paid by the business and its employees. By statute, the annual form must be audited by an independent certified public accountant acceptable to SBA.⁵⁶

SBA's risk-management procedures require its financial analysts to conduct quarterly risk assessments to determine the level of oversight each SBIC requires based on financial performance, capital impairment percentage, and other information. SBA has three levels of oversight: normal, enhanced, and intensive. Normal oversight, which covers SBICs that are in good financial standing and regulatory compliance, includes an SBA analysis of the SBIC's quarterly and annual statements and a review of the value of the SBIC's portfolio companies. SBA provides enhanced oversight to SBICs experiencing financial difficulties. Enhanced oversight includes stepped-up interactions between SBA and the SBIC's managers—for example, SBA staff visits to the SBIC's portfolio companies. Intensive oversight targets SBICs with serious outstanding regulatory violations, excessive financial losses, and capital impairment. Intensive oversight includes face-to-face reviews with SBA officials, more frequent reporting requirements, and increased monitoring of the SBIC's portfolio companies. In September 2015, SBA staff told us they were modifying and refining the risk-assessment procedures of the SBIC program to establish a more robust data-driven approach and interactive process for establishing risk ratings.

Examinations

The Small Business Investment Act generally requires SBA to examine all SBICs at least every 2 years to (1) determine whether licensees are complying with the act and its implementing regulations, (2) help SBA assess the financial condition of licensees and SBA's financial vulnerability, and (3) ensure the accuracy of information licensees submit to SBA. SBA's goal is to examine SBICs that receive SBA leverage on a 12-month cycle and nonleveraged SBICs on an 18-month cycle. SBA usually conducts examinations on-site at the SBIC, and SBA officials told us the examinations generally last about 1 week. SBA examiners also

⁵⁶15 U.S.C. § 687b(d)(1)(C)(i); 13 C.F.R. § 107.630(a)(1).

may decide that field visits to the small businesses that obtain financing from an SBIC would meaningfully enhance the examination process. During the on-site visits, examiners verify information provided by the SBIC fund managers, review licensees' financial records, and conduct regulatory reviews of the licensees' practices.

We reviewed the data on all examination reports issued in 2014 for debenture SBICs and found that 15 percent of examinations resulted in findings—that is, they were believed to be major violations of the Small Business Investment Act or related regulations, which include things like improper valuation of investments and unresolved matters from prior examinations.⁵⁷ According to SBA's guidance, SBICs must resolve examination findings related to regulatory violations within an established time frame, ideally no more than 180 days from issuance of the examination report. As of March 2015, findings had been resolved in 17 of the 20 examination reports issued in 2014 that contained findings. Two others were in the process of being resolved, and one report was for an SBIC that was no longer active.

In September 2013, the SBA Office of Inspector General (OIG) issued an audit report on the SBIC examination process.⁵⁸ The OIG found that the SBIC examination function generally addressed statutory requirements and agency policy by conducting examinations at least every 2 years and checking SBICs for regulatory violations. However, the OIG also reported that SBA had largely focused on the frequency and quantity of examinations as opposed to quality, increasing the risk that examinations would be inaccurate or incomplete. The OIG report noted that there had been a significant decrease in examination reports with findings, and that fewer findings could indicate that the quality of the assessments had suffered. The audit report also cited outdated guidance, incomplete examination checklists, inadequate strategic planning, and the absence of training and technology upgrades.

⁵⁷For the examination reports issued in 2014 for debenture SBICs, about 15 percent and 17 percent of the examinations of multiple-license and single-license SBICs, respectively, had findings.

⁵⁸U.S. Small Business Administration, Office of Inspector General, *Improved Examination Quality Can Strengthen SBA's Oversight of Small Business Investment Companies*, Audit Report 13-22 (Washington, D.C.: Sept. 30, 2013).

Liquidation and Asset Recovery

The OIG recommended that SBA (1) create and execute a plan to improve the internal operations of the examination function, (2) update and improve the existing examination checklist, and (3) assess the costs of the examination function and prepare cost-benefit analyses for several funding options to cover all examination costs. The OIG report stated that SBA did not concur with the OIG's first recommendation. However, OIG officials told us that SBA had since revised its examination standard operating procedures, an action that constituted a satisfactory response to the first recommendation, and that the recommendation ought to be closed in the near future. SBA agreed with the second recommendation and took actions to improve the checklist that examiners used when conducting examinations. SBA published updated examination guidelines in October 2013, and the OIG closed the recommendation. SBA agreed with the third recommendation and developed a proposed rule to address it, which was undergoing internal review as of September 2015.

If an SBIC has financial or regulatory problems that cannot be resolved, SBA has the authority to transfer it to the jurisdiction of the Office of SBIC Liquidation. The primary reason for placing SBICs in liquidation is significant portfolio losses that result in capital impairment. SBICs can also be liquidated if they do not comply with statutory or regulatory requirements. The office oversees the liquidation process until the SBIC repays all leverage or all assets have been sold or written off. According to SBA's liquidation procedures, the office's primary goal is to recover funds for SBA in the shortest time possible and minimize financial losses. To this end, the office prepares a strategy to maximize SBA's net recoveries and minimize the adverse effect on the small businesses involved. As of September 30, 2014, SBA estimated it had recovered 50 percent of leverage for SBICs placed in liquidation since the program's inception in 1958, and estimated that the ultimate recovery rate would be 60 percent.⁵⁹

⁵⁹The amount of leverage for SBICs in liquidation that was expected to be recovered represents the cumulative amount recovered, as of the end of that fiscal year, of all SBICs that have participated in the program since its inception in 1958.

SBA Oversight Mechanisms for Managing Program Risk Are Largely the Same for Single and Multiple Licensees

SBA applies largely the same risk management and oversight mechanisms to single and multiple licensees, according to agency staff. All SBICs are distinct legal entities and are monitored individually. Every SBIC must submit quarterly and annual financial statements and undergo periodic examinations. SBA staff told us that although SBICs were monitored as separate entities, problems with one SBIC managed by a multiple licensee could lead to more careful scrutiny of the licensee's other SBICs, especially if the problems appeared to be related to management failures or some form of malfeasance. SBA staff told us that they assigned the same operations analyst to multiple-license SBICs under common control to give that analyst a better understanding of all the SBICs controlled by a licensee.

SBIC licensees seeking a subsequent license generally must undergo the same application and licensing process, according to SBA. For example, SBIC fund managers told us that applicants seeking a subsequent SBIC license usually must submit a new management assessment questionnaire, as circumstances may have changed since the prior application (such as the management team or the investment strategy). However, SBA staff told us that their procedures allowed some flexibility and generally were intended to streamline the time required to grant the subsequent license. For example, SBA has some discretion to accept a shorter memorandum from the applicant in lieu of a second management assessment questionnaire if the SBIC has not experienced significant changes in management or investment strategy. However, several multiple licensees with whom we spoke said that even under such circumstances, they were not given the option to submit a memorandum and instead had to submit a management assessment questionnaire, which was more time-consuming to complete.

According to SBA staff, the agency evaluates a number of specific conditions when determining whether to grant a subsequent license. For example, according to SBA's application and licensing procedures, an applicant that is already operating one or more SBICs must have at least a 2-year track record in the SBIC program, clean audit opinions from the SBIC's independent public accountant, and no unresolved regulatory violations, among other specified conditions. According to SBA, from 2010 to 2014, fund managers seeking a subsequent license had a 70 percent approval rate, as compared with about 50 percent for first-time license applicants. SBA staff attributed the higher approval rate of subsequent applicants to their prior experience with the licensing process and their demonstrated track record in the SBIC program.

Other Factors May Influence Program Performance

While SBA has procedures designed to manage financial risk to taxpayers from SBICs and their investments, the effect of SBA oversight on financial performance would be difficult to measure because it cannot easily be isolated from other internal and external factors, which include program design, economic conditions, and the characteristics of the SBICs and their investments.

Program Design

The specific rules, sometimes set by statute, governing the different types of SBICs can affect the performance of the SBIC program as a whole. For instance, the participating securities program, which was created by statute, has been responsible for the majority of SBIC program losses in recent years, and its termination improved overall program performance. SBA staff and at least two research studies have stated that the participating securities program's losses resulted from the statutory design of the program.⁶⁰ The program focused on equity investments, which generally are considered to have relatively higher risks, but the program was structured so that SBA advanced the interest payments (known as prioritized payments) to bond holders and was only repaid advanced prioritized payments out of the SBIC's profits. As such, as of May 1, 2015, SBA estimated that it had contributed 59 percent of the total amount of SBA leverage drawn and private capital contributed by the participating securities SBICs but received less than 27 percent of the profit made by these SBICs (including all reimbursed prioritized payments, adjustments, and SBA annual charges).

Economic Conditions

Program performance also can be affected by economic conditions, such as the availability of credit and capital, interest rates, the equities markets, and economic growth, all of which can affect the financial performance of SBIC investments. According to SBA, the financial performance of the SBIC program generally follows trends in the private equity industry and stock markets. Two studies have noted that the participating securities program's losses in the early 2000s were linked to the fall of the stock value of their investments in technology startup and early-stage small businesses.⁶¹ Additionally, SBA noted that the interest rates on the SBIC

⁶⁰For example, see Timothy R. Dahlstrom, "The Rise and Fall of the Participating Securities SBIC Program: Lessons in Public Venture Capital Management," *Perspective in Public Affairs*, vol. 6 (Spring 2009).

⁶¹These studies are cited in Dahlstrom (Spring 2009) and Congressional Research Service, *SBA Small Business Investment Company Program* (July 14, 2015).

Characteristics of SBICs and their Investments

leverage draws were connected with the interest rates of the 10-year Treasury Note. The interest rates on the SBIC leverage draws have been low in recent years, helping SBICs perform better financially by realizing higher profit margins on their small business investments.

The age of an SBIC can affect its investment performance, and thus the age of SBICs overall affects the financial performance of the SBIC program. SBA told us that it was more challenging to assess the financial performance of relatively young SBICs because their investments had not yet reached the stage of generating returns and demonstrating performance. The median age of a debenture SBIC transferred to liquidation was 10 years, according to SBA. In its 2014 SBIC annual report, SBA noted that no debenture SBICs less than 5 years old (which represented 71 percent of its outstanding debenture leverage as of September 30, 2014) had been transferred to liquidation, compared with 3 percent of those between 5 and 10 years. As a result, the relatively low percentage of debenture SBICs currently in liquidation may be a function of the SBIC program's significant growth in the last 5 years, because younger funds typically have not become capitally impaired. The financial performance of the debenture program may change in future years, SBA staff told us, as the investment performance of the younger SBICs becomes clearer.

The proportional share of debt and equity investments made by the SBICs also can affect performance of individual SBICs and the SBIC program as a whole. SBA staff noted that, generally speaking, debt investments are considered relatively less risky than investments in equity or with equity features. Debt investments rose from less than 21 percent of SBIC financing in 2005 to about 64 percent in 2014. SBA attributed this trend to the termination of the participating securities program in 2004 and the decline in availability of debt capital in the marketplace between 2009 and 2014. SBA staff told us they anticipated that SBIC investments would shift to a greater share of equity investments, in line with historical norms, as capital market conditions continued to improve and more debt capital became available to small businesses from traditional banks. Such a shift to equity investments could result in increased financial risk for the SBIC program in future years.

Conclusions

There would be benefits to providing specific guidance to SBIC licensees on how to answer the voluntary questions asked in Form 1031 on investments in minority-, women-, and veteran-owned businesses. SBA does not provide such guidance because it believes the questions are

self-explanatory. However, specific guidance could clarify how to define these businesses and other ambiguities, which could help improve response rates and ensure the consistency of these data. More reliable data in this area also would be consistent with SBA's strategic plan, which cites expanding access to financial capital for such businesses as a strategic priority of the SBIC program. Providing clear and specific guidance to SBIC licensees on how to collect and report these data would help improve the quality, consistency, and value of the information reported.

Recommendation for Executive Action

The Administrator of the Small Business Administration should direct the Office of Investment and Innovation to provide clear and specific guidance to SBIC licensees on how to collect and report data in Form 1031 on their investments in minority-, women-, and veteran-owned businesses.

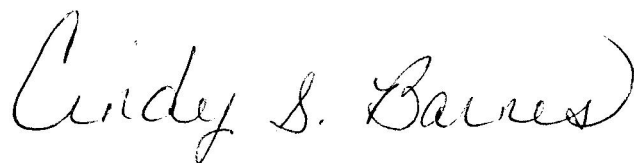
Agency Comments

We provided a draft of this report to SBA. In its response, SBA neither agreed nor disagreed with the recommendation addressed to it and provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the Administrator of the Small Business Administration, the appropriate congressional committees, and other interested parties. In addition, the report will be available at no charge on GAO's website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-7215 or brownbarnesc@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix II.

Sincerely yours,



Cindy Brown Barnes
Director
Education, Workforce, and Income Security

Appendix I: Objectives, Scope, and Methodology

The objectives of our report were to examine the (1) characteristics of multiple-license Small Business Investment Companies (SBIC) compared with single-license SBICs, (2) investment performance of multiple licensees compared with single licensees and the attributes of the small businesses in which SBICs invest, and (3) overall financial performance of the SBIC program and the extent SBA manages the risk associated with the program.¹

To address the first and second objectives, we analyzed and examined primary data from the Small Business Administration's (SBA) SBIC databases and secondary data provided to us in summary format by SBA for fiscal years 2005 through 2014. We used the data to distinguish between single- and multiple-license SBICs and determine differences between these two categories for characteristics such as the number of SBICs and SBIC managers, amount of SBA leverage held, and geographic distribution. We also analyzed data that SBIC licensees submitted to SBA through the annual Portfolio Financing Report (Form 1031) for fiscal years 2005 through 2014. We sorted these data to distinguish between single- and multiple-license SBICs in relation to characteristics of the small businesses in which the SBICs invested, such as the number and dollar amount of investments. Additionally, we used the Form 1031 data to categorize the businesses in which SBICs invested by industry sector, using the North American Industry Classification System. To describe the investments' geographic distribution and extent of investment in smaller enterprises, we analyzed summary data prepared by SBA that was derived from quarterly data the agency receives from SBICs on the required Form 468. All dollar values expressed in our report are nominal and were not adjusted for inflation.

To compare the investment performance of single- and multiple-license SBICs, we analyzed two measures of SBIC's investment performance: (1) the rate at which SBICs were transferred to liquidation, and (2) the estimated loss rate. The secondary data for these measures were provided to us by SBA, which derived the information from data in its SBIC databases and the fiscal year 2013 Ultimate Loss Report. We calculated the liquidation rate by dividing the number of SBICs that were

¹For this report, we use "single licensee" to refer to an entity that holds one SBIC license, and "multiple licensee" to refer to an entity that holds two or more SBIC licenses under common control. We use "single-license SBIC" to refer to an SBIC held by a single licensee, and "multiple-license SBIC" to refer to an SBIC held by a multiple licensee.

liquidated by the total number of licensed SBICs that were issued leverage. We also reviewed the estimated loss rate calculated by SBA—that is, the anticipated ultimate losses divided by the sum of leverage redeemed in operations, leverage transferred to liquidation, and draws in liquidation.² In addition to these two performance measures, we analyzed summary statistics provided by SBA on the extent of capital impairment by single- and multiple-license SBICs in operation, which SBA derived from the quarterly data it receives from SBICs. Because the age of an SBIC can affect its investment performance, we also reviewed differences in average performance based on year of license, and calculated the average ages of multiple- and single-license SBICs for the aggregate period 2005 through 2014. However, the data available to us did not allow us to compare the performance of multiple versus single licensees that were licensed in specific years.

We analyzed investment performance in aggregate because looking at performance in a single year can be misleading, according to SBA staff—given that even successful SBICs see few returns in their first several years (while the businesses in which they have invested mature). Our analysis of investment performance covered 2005 through 2014 because 2005 was the year in which SBA began collecting data in a manner that allowed the performance of multiple versus single licensees to be isolated. Our analysis included only SBICs under the jurisdiction of the Office of SBIC Operations or Office of SBIC Liquidation as of September 30, 2005, and all SBICs licensed since that time through July 15, 2014.

To assess the reliability of data on characteristics of SBICs, their investments, and their investment performance, we reviewed relevant SBA documents, including SBA's standard operating procedures, and regulations related to the process for updating, maintaining, and monitoring such data. We also performed electronic testing for obvious errors in accuracy and completeness. We interviewed knowledgeable SBA officials on, among other things, data limitations and how the data are collected and captured. Where we identified questions related to the

²The anticipated ultimate losses represent actual charge-offs—the amount of leverage in liquidation that SBA determines it will not be able to recover—and anticipated future losses as estimated by the Office of Liquidation each year. The estimated loss rate was prepared by SBA at our request for the purpose of comparing the financial performance of single- and multiple-license SBICs. It does not include projected losses on SBA leverage to SBICs in operation that is still outstanding. According to SBA, the estimated loss rate is an appropriate measure for comparing the investment performance of single- and multiple-license SBICs.

data, we clarified them through discussions with SBA staff. We determined that these data were sufficiently reliable for our reporting purposes.

We also reviewed and analyzed data provided to us by SBA on the number of minority and female SBIC managers and the number of SBICs located in low- or moderate-income areas as of July 15, 2014. SBA does not routinely collect such information, but at our request, the agency conducted an informal survey of its operations analysts. SBA staff told us that because this was an informal survey, they could not make any representation about the completeness or accuracy of the information. Although the data have limitations, we are reporting the data to provide contextual information on the number of minority or female SBIC managers and SBICs located in low- or moderate-income areas. In addition, we reviewed data collected by SBA on the minority, women, and veteran ownership of the small businesses in which SBICs invest. We determined that these data were not sufficiently reliable for our reporting purposes because, among other things, the reporting of this information by SBICs is voluntary, the response rate could not be fully assessed, and SBA told us it could not make any representation about the completeness or accuracy of the data. To identify SBIC program priorities and goals related to minority, women, and veteran ownership of small businesses in which SBICs invest, we reviewed SBA's Fiscal Years 2014–2018 Strategic Plan and SBIC program annual reports.³

To address the third objective, we examined data provided to us by SBA on the aggregate financial performance of the SBIC program, including data from the SBIC ultimate loss reports prepared by SBA. For the program overall, SBA provided ultimate loss data for fiscal years 1994 through 2014. For the SBIC debenture and participating securities programs in particular, SBA provided these data for fiscal years 2003 through 2014 because 2003 was the year in which SBA started separately reporting losses for these two programs. We also reviewed the annual credit subsidy estimates and reestimates for the SBIC program from fiscal years 1992 through 2014 in the corresponding years'

³Small Business Administration, *Fiscal Years 2014–2018 Strategic Plan* (Washington, D.C.: 2014). Annual reports included, for example, Small Business Administration, *The Small Business Investment Company Program (SBIC), Annual Report for Fiscal Year Ending September 30, 2013* (Washington, D.C.: 2014), and *The Small Business Investment Company Program (SBIC), Annual Report, Fiscal Year 2014* (Washington, D.C.: 2015).

President's Budget. To assess the reliability of these data, we reviewed SBA's annual financial reports on how SBA estimates financial losses and credit subsidy costs of the SBIC program. We also interviewed knowledgeable SBA staff on how loss and credit subsidy data are estimated, maintained, and reviewed by SBA and external parties such as the Office of Management and Budget. We also conducted electronic testing of the data for obvious errors, and we did not identify any. We determined the data to be sufficiently reliable for the purpose of reporting the financial performance of the SBIC program overall and SBICs by type.

To examine the credit subsidy cost and funding for administrative costs of the SBIC program, we reviewed SBIC's authorizing legislation and reviewed requirements and guidance related to credit subsidy cost, including the Federal Credit Reform Act of 1990 and Office of Management and Budget Circulars A-11 Part 5 and A-129, which prescribe guidance on federal credit programs and credit subsidy costs.⁴ We also reviewed the 2014 SBA annual agency financial report, the annual SBIC program reports for fiscal years 2012 through 2014 (the most recent available), and an SBA report on the SBIC debenture program submitted to the Office of Management and Budget in November 2014.⁵

To assess the extent to which the SBIC program manages risk, we reviewed SBIC's authorizing legislation—the Small Business Investment Act of 1958—and its amendments and implementing regulations; SBA's standard operating procedures, policies, and technical guidance; SBA annual program and financial reports; and forms and guidance associated with the application and licensing process.⁶ We did not validate the extent to which SBA follows its written policies and procedures, although where possible we sought to corroborate the extent through testimonial and documentary evidence. We reviewed reports by the SBA Office of Inspector General and we interviewed staff of this office to discuss their findings and SBA's implementation of recommendations related to the SBIC examination

⁴Office of Management and Budget, Circular No. A-11 Part 5, *Federal Credit* (July 2014) and Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables* (January 2013).

⁵Small Business Administration, *The Small Business Investment Company (SBIC) Program: Office of Management and Budget (OMB) Program Review* (Washington, D.C.: November 2014).

⁶Pub. L. No. 85-699, 72 Stat. 689 (codified as amended at 15 U.S.C. §§ 661-697g) and 13 C.F.R. pt. 107.

process. We also reviewed the data from SBA's examination reports issued in fiscal year 2014 for debenture SBICs and analyzed the number and type of examination findings for SBICs overall and for multiple and single licensees in particular. To assess the reliability of these data, we reviewed SBA's standard operating procedures for conducting examinations, interviewed knowledgeable agency officials on how the examination data were collected and any associated data limitations, and traced and verified the accuracy of our calculations. We determined these data were sufficiently reliable for the purposes of reporting information on numbers of examination findings.

For all of the objectives, we reviewed statements and transcripts of relevant congressional hearings and relevant research and studies by industry stakeholders, SBA, and the Congressional Research Service, as well as prior GAO reports.⁷ In addition, we conducted interviews with staff from federal agencies—SBA, the Department of Commerce's Minority Business Development Agency, and the Congressional Research Service — representatives of the Small Business Investor Alliance, which represents the interests of SBICs; nine SBIC fund managers; an attorney who has represented and advised multiple SBICs; and an academic researcher who has studied the SBIC program. We selected the academic researcher based on a suggestion by the Small Business Investor Alliance and because his work was cited in documents we reviewed. We selected the nine SBIC fund managers who we interviewed to represent a mix of multiple- and single-license SBICs, geographic locations, size of investments, and industries, among other criteria. In addition, we solicited suggestions from the Small Business Investor Alliance and other industry stakeholders for managers to interview. We selected the SBIC fund managers and industry stakeholders to gain a range of perspectives on the SBIC program; however, their views are not generalizable.

⁷For example, Small Business Administration, *The Small Business Investment Company (SBIC) Program Annual Report, Fiscal Year 2014*; Timothy R. Dahlstrom, "The Rise and Fall of the Participating Securities SBIC Program: Lessons in Public Venture Capital Management," *Perspectives in Public Affairs*, vol. 6 (Spring 2009); and Congressional Research Service, *SBA Small Business Investment Company Program* (July 14, 2015). Also see GAO, *Government Contracting: Federal Efforts to Assist Small Minority Owned Businesses*, [GAO-12-873](#) (Washington, D.C.: Sept. 28, 2012); and *Small Business: Update of Information on SBA's Small Business Investment Company Programs*, [GAO/RCED-97-55](#) (Washington, D.C.: Feb. 21, 1997).

We conducted this performance audit from July 2014 to January 2016, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: GAO Contact and Staff Acknowledgments

GAO Contact

Cindy Brown Barnes, (202) 512-7215 or brownbarnesc@gao.gov.

Staff Acknowledgments

In addition to the individual named above, Jason Bromberg (Assistant Director), Bethany Benitez, Benjamin A. Bolitzer, Emily Chalmers, Anna Chung, David Dornisch, Isidro Gomez, Marc Molino, and Emily Upstill made key contributions to this report.

Appendix III: Accessible Data

Data Tables

Data Table for Highlights Figure: Percent of debenture SBICs transferred to liquidation, September 30, 2005 to July 15, 2014

Multiple-license debenture SBICs	6%
Single-license debenture SBICs	39%

Data Table for Figure 2: Number of Debenture Small Business Investment Companies (SBIC) and Licensees, as of the End of Fiscal Years 2005–2014

Note: One manager can manage more than one multiple-license debenture SBIC.

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Single-License Debenture SBICs / Managers	101	95	78	69	57	60	51	53	55	57
Multiple-License Debenture SBIC Managers	14	23	33	36	40	44	51	58	66	69
Multiple-License Debenture SBICs	26	37	54	60	69	80	92	105	120	130

Data Table for Figure 3: Number of Small Business Investment Companies (SBIC), by License and by Type, as of the End of Fiscal Years 2005–2014

Year	Single-License SBICs	Multiple-License SBICs
2005	347	71
2006	299	97
2007	242	127
2008	221	127
2009	189	126
2010	175	132
2011	152	147
2012	139	162
2013	122	170
2014	118	176

Single- License Category	Debenture	Participating	Bank-Owned / Non-leveraged	Specialized
2005	101	165	53	28
2006	95	138	44	22
2007	78	111	39	14
2008	69	101	37	14

Single- License Category	Debenture	Participating	Bank-Owned / Non-leveraged	Specialized
2009	57	86	34	12
2010	60	70	33	12
2011	51	60	29	12
2012	53	49	25	12
2013	55	37	21	9
2014	57	30	23	8

Multiple- License Category	Debenture	Participating	Bank-Owned / Non-leveraged	Specialized
2005	26	21	22	2
2006	37	35	23	2
2007	54	53	18	2
2008	60	48	17	2
2009	69	41	14	2
2010	80	37	14	1
2011	92	37	17	1
2012	105	37	19	1
2013	120	26	22	2
2014	130	23	22	1

Data Table for Figure 4: SBA Leverage Held by Small Business Investment Companies (SBIC), All Types, as of the End of Fiscal Years 2005–2014

Year	Single-license	Multiple-license
2005	5.388397	0.967023
2006	5.208181	1.65332
2007	4.390016	2.74658
2008	4.418615	2.844119
2009	3.874486	2.925444
2010	3.070645	3.268871
2011	2.807462	3.625615
2012	2.411451	4.024297
2013	2.258968	4.691596
2014	2.116037	5.600526

Data Table for Highlights Figure and Figure 5: SBA Leverage Held by Debenture Small Business Investment Companies (SBIC), as of the End of Fiscal Years 2005–2014

Year	Single-license	Multiple-license
2005	1.29633	0.408816
2006	1.193965	0.710501
2007	1.071896	1.048346
2008	1.209473	1.318216
2009	1.170951	1.721041
2010	1.080419	2.329385
2011	1.367615	2.877255
2012	1.443125	3.42743
2013	1.70217	4.21723
2014	1.794445	5.21062

Data Table for Figure 6: Distribution of Multiple- and Single-License Debenture Small Business Investment Companies (SBIC), by State, as of September 30, 2014

U.S. State or Territory (Deb only)	SL (0)	Percent	U.S. State or Territory (Deb only)	ML (1)	Percent
New York	13	22.8%	New York	17	13.1%
California	5	8.8%	Illinois	14	10.8%
Illinois	5	8.8%	North Carolina	12	9.2%
Maryland	5	8.8%	California	9	6.9%
Texas	4	7.0%	Pennsylvania	9	6.9%
Other	25	43.9%	Other	69	53.1%

Data Table for Figure 7: Number of Small Business Investment Companies (SBIC) in Capital Impairment, by Type and by Quarter, Calendar Years 2005–2014

Period	Participating Securities SBICs		Debenture SBICs		Participating securities SBICs Filing GAO	Debenture SBICs Filing GAO	All SBICs Filing GAO
	Single SBIC	Sister Fund SBIC	Single SBIC	Sister Fund SBIC	Calc	Calc	Calc
Q1 2005	14	11	9	3	25	12	37
Q2 2005	7	5	8	7	12	15	27
Q3 2005	7	4	7	4	11	11	22
Q4 2005	4	1	2	1	5	3	8

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Period	Participating Securities SBICs		Debenture SBICs		Participating securities SBICs Filing GAO	Debenture SBICs Filing GAO	All SBICs Filing GAO
	Single SBIC	Sister Fund SBIC	Single SBIC	Sister Fund SBIC	Calc	Calc	Calc
Q1 2006	4	1	3	3	5	6	11
Q2 2006	4	1	2	4	5	6	11
Q3 2006	2	3	4	5	5	9	14
Q4 2006	4	2	2	5	6	7	13
Q1 2007	5	5	2	5	10	7	17
Q2 2007	6	1	4	2	7	6	13
Q3 2007	3	2	3	2	5	5	10
Q4 2007	1	3	3	3	4	6	10
Q1 2008	1	3	3	3	4	6	10
Q2 2008	4	2	4	3	6	7	13
Q3 2008	7	4	2	3	11	5	16
Q4 2008	11	2	4	2	13	6	19
Q1 2009	11	2	4	2	13	6	19
Q2 2009	8	3	3	2	11	5	16
Q3 2009	7	6	4	1	13	5	18
Q4 2009	6	3	1	3	9	4	13
Q1 2010	6	3	3	3	9	6	15
Q2 2010	4	2	2	1	6	3	9
Q3 2010	6	2	2	1	8	3	11
Q4 2010	6	0	1	1	6	2	8
Q1 2011	6	0	1	2	6	3	9
Q2 2011	1	0	1	1	1	2	3
Q3 2011	2	0	1	1	2	2	4
Q4 2011	1	2	0	2	3	2	5
Q1 2012	1	2	0	2	3	2	5
Q2 2012	2	2	0	1	4	1	5
Q3 2012	1	0	0	0	1	0	1
Q4 2012	1	3	0	2	4	2	6
Q1 2013	3	0	1	2	3	3	6
Q2 2013	2	0	1	1	2	2	4
Q3 2013	2	0	1	2	2	3	5
Q4 2013	0	2	1	1	2	2	4
Q1 2014	0	2	0	0	2	0	2
Q2 2014	1	0	0	0	1	0	1

Period	Participating Securities SBICs		Debenture SBICs		Participating securities SBICs Filing GAO	Debenture SBICs Filing GAO	All SBICs Filing GAO
	Single SBIC	Sister Fund SBIC	Single SBIC	Sister Fund SBIC	Calc	Calc	Calc
Q3 2014	0	0	0	0	0	0	0
Q4 2014	1	1	0	0	2	0	2

Data Table for Figure 8: Number and Dollar Amount of Small Business Investment Company (SBIC) Investments to Small Businesses, as of the End of Fiscal Years 2005–2014

	Single-License	Multiple-License	Total
2005	1535	829	2364
2006	1295	911	2206
2007	1078	1064	2142
2008	865	1904	2769
2009	627	909	1536
2010	617	757	1374
2011	496	874	1370
2012	419	706	1125
2013	345	755	1100
2014	405	731	1136

	Single-License	Multiple-License	Total
2005	2.295001	0.600098	2.895099
2006	2.007174	0.890069	2.897243
2007	1.559022	1.088826	2.647848
2008	1.276220	1.151135	2.427355
2009	0.822809	1.033312	1.856121
2010	0.734721	1.312410	2.047131
2011	0.920180	1.913191	2.833371
2012	1.262414	1.965016	3.227430
2013	1.376683	2.121632	3.498315
2014	2.070261	3.394299	5.464561

Data Table for Figure 9: Industry Categories for Small Businesses Receiving Small Business Investment Company (SBIC) Investments, as of September 30, 2014

Industry	Percent of Total Single License Financing	Percent of Total Multiple License Financing
Manufacturing	34%	26%
Professional Services	18%	13%
Information	17%	12%
Health Care and Social Assistance	5%	10%
Administrative and Support and Waste Management	3%	7%
Finance and Insurance	3%	2%
Other Services	2%	1%
Educational Services	2%	1%
Transportation and Warehousing	2%	4%
Accommodation and Food Services	2%	2%
Wholesale Trade	2%	8%
Construction	2%	2%
Mining	2%	4%
Real Estate	1%	2%
Retail Trade	3%	3%
Management of Companies and Enterprises	1%	1%
Arts, Entertainment, and Recreation	0%	2%
Utilities	0%	0%
Agriculture, Forestry, Fishing and Hunting	0%	0%
Public Administration	0%	0%

Data Table for Figure 10: Geographic Distribution for Small Businesses Receiving Small Business Investment Company (SBIC) Investments, from October 1989 to June 2014

STATENAME	Single_Number	Single_Dollars	Multiple_Number	Multiple_Dollars	Total_Number	Total_Dollars
New York	4365	\$ 2,111,330,350.00	9154	\$ 4,272,349,364.00	13519	\$ 6,383,679,714.00
California	6699	\$ 4,790,928,775.00	3592	\$ 4,979,220,853.00	10291	\$ 9,770,149,628.00

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STATENAME	Single_Number	Single_Dollars	Multiple_Number	Multiple_Dollars	Total_Number	Total_Dollars
Illinois	2960	\$ 1,493,149,945.00	1568	\$ 1,169,478,007.00	4528	\$ 2,662,627,952.00
Texas	2204	\$ 1,547,042,462.00	2119	\$ 2,741,776,029.00	4323	\$ 4,288,818,491.00
Massachusetts	2151	\$ 1,458,342,663.00	2011	\$ 1,606,452,129.00	4162	\$ 3,064,794,792.00
New Jersey	1418	\$ 914,897,894.00	1915	\$ 1,376,677,745.00	3333	\$ 2,291,575,639.00
Florida	1216	\$ 927,650,358.00	900	\$ 1,415,907,310.00	2116	\$ 2,343,557,668.00
Pennsylvania	946	\$ 983,829,267.00	1150	\$ 1,240,831,506.00	2096	\$ 2,224,660,773.00
Virginia	844	\$ 646,484,528.00	492	\$ 623,894,834.00	1336	\$ 1,270,379,362.00
Colorado	816	\$ 728,526,401.00	457	\$ 967,812,305.00	1273	\$ 1,696,338,706.00
Georgia	686	\$ 743,653,622.00	563	\$ 889,259,088.00	1249	\$ 1,632,912,710.00
Maryland	773	\$ 441,639,138.00	436	\$ 457,328,593.00	1209	\$ 898,967,731.00
Connecticut	542	\$ 565,924,387.00	526	\$ 731,553,257.00	1068	\$ 1,297,477,644.00
Washington	585	\$ 458,831,394.00	470	\$ 515,962,120.00	1055	\$ 974,793,514.00
Utah	220	\$ 199,314,461.00	810	\$ 436,229,298.00	1030	\$ 635,543,759.00
North Carolina	473	\$ 457,230,802.00	551	\$ 1,035,161,038.00	1024	\$ 1,492,391,840.00
Ohio	576	\$ 856,169,997.00	436	\$ 694,118,904.00	1012	\$ 1,550,288,901.00
Minnesota	429	\$ 391,396,025.00	569	\$ 690,286,997.00	998	\$ 1,081,683,022.00
Michigan	811	\$ 710,271,762.00	172	\$ 441,376,100.00	983	\$ 1,151,647,862.00
Missouri	343	\$ 455,921,053.00	405	\$ 501,897,060.00	748	\$ 957,818,113.00
Tennessee	379	\$ 386,813,401.00	282	\$ 597,589,021.00	661	\$ 984,402,422.00
Kansas	426	\$ 189,070,674.00	184	\$ 269,074,083.00	610	\$ 458,144,757.00
Arizona	295	\$ 418,669,326.00	311	\$ 428,028,074.00	606	\$ 846,697,400.00
Wisconsin	271	\$ 308,116,026.00	224	\$ 446,831,225.00	495	\$ 754,947,251.00

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STATENAME	Single_Number	Single_Dollars	Multiple_Number	Multiple_Dollars	Total_Number	Total_Dollars
Indiana	329	\$ 226,719,850.00	135	\$ 280,513,416.00	464	\$ 507,233,266.00
Oregon	275	\$ 191,754,205.00	184	\$ 253,986,929.00	459	\$ 445,741,134.00
New Hampshire	221	\$ 145,187,813.00	169	\$ 154,316,519.00	390	\$ 299,504,332.00
Kentucky	197	\$ 153,722,357.00	149	\$ 232,261,579.00	346	\$ 385,983,936.00
Louisiana	218	\$ 372,417,643.00	106	\$ 207,803,323.00	324	\$ 580,220,966.00
South Carolina	81	\$ 131,377,218.00	218	\$ 423,634,018.00	299	\$ 555,011,236.00
Alabama	169	\$ 169,811,224.00	129	\$ 176,482,165.00	298	\$ 346,293,389.00
Oklahoma	163	\$ 108,736,638.00	128	\$ 199,233,677.00	291	\$ 307,970,315.00
Iowa	160	\$ 112,752,229.00	114	\$ 128,818,176.00	274	\$ 241,570,405.00
Rhode Island	209	\$ 137,745,603.00	57	\$ 100,920,422.00	266	\$ 238,666,025.00
Arkansas	169	\$ 52,176,685.00	92	\$ 79,024,609.00	261	\$ 131,201,294.00
District of Col.	140	\$ 77,216,775.00	73	\$ 78,135,813.00	213	\$ 155,352,588.00
Mississippi	66	\$ 46,782,853.00	146	\$ 108,664,569.00	212	\$ 155,447,422.00
New Mexico	55	\$ 53,300,707.00	135	\$ 92,945,176.00	190	\$ 146,245,883.00
West Virginia	151	\$ 70,236,986.00	23	\$ 25,015,523.00	174	\$ 95,252,509.00
Delaware	53	\$ 62,820,265.00	116	\$ 126,188,614.00	169	\$ 189,008,879.00
Nevada	90	\$ 74,545,085.00	59	\$ 84,880,363.00	149	\$ 159,425,448.00
Puerto Rico	130	\$ 85,603,783.00	12	\$ 6,872,595.00	142	\$ 92,476,378.00
Maine	59	\$ 152,205,406.00	66	\$ 83,007,347.00	125	\$ 235,212,753.00
Vermont	57	\$ 49,618,931.00	57	\$ 75,449,060.00	114	\$ 125,067,991.00
South Dakota	25	\$ 35,848,136.00	73	\$ 57,388,420.00	98	\$ 93,236,556.00
Idaho	16	\$ 12,327,814.00	38	\$ 37,834,423.00	54	\$ 50,162,237.00

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STATENAME	Single_Number	Single_Dollars	Multiple_Number	Multiple_Dollars	Total_Number	Total_Dollars
Nebraska	21	\$ 39,034,495.00	29	\$ 49,988,205.00	50	\$ 89,022,700.00
Montana	11	\$ 6,642,063.00	25	\$ 20,206,037.00	36	\$ 26,848,100.00
Hawaii	29	\$ 7,708,356.00	6	\$ 21,805,900.00	35	\$ 29,514,256.00
North Dakota	6	\$ 5,681,620.00	15	\$ 20,678,750.00	21	\$ 26,360,370.00
Virgin Islands	1	\$ 1,090,000.00	14	\$ 1,927,135.00	15	\$ 3,017,135.00
Wyoming	2	\$ 777,769.00	7	\$ 46,749,218.00	9	\$ 47,526,987.00
Alaska	4	\$ 2,362,876.00	3	\$ 962,207.00	7	\$ 3,325,083.00
Guam	0	\$ -	0	\$ -	0	\$ -
TOTAL	33535	\$ 24,771,410,096.00	31675	\$ 31,704,789,128.00	65210	\$ 56,476,199,224.00

Data Table for Figure 11: Small Business Investment Company Program: Ultimate Loss Rate, End of Fiscal Years 1994–2014

Fiscal Years	Overall SBIC
1994	18.0%
1995	17.6%
1996	15.3%
1997	14.5%
1998	13.8%
1999	11.9%
2000	9.9%
2001	8.4%
2002	10.0%
2003	25.7%
2004	26.0%
2005	21.9%
2006	19.3%
2007	16.8%
2008	16.0%
2009	18.9%
2010	19.6%

Fiscal Years	Overall SBIC
2011	19.2%
2012	18.0%
2013	17.4%
2014	15.9%

Data Table for Figure 12: Small Business Investment Company (SBIC) Program: Ultimate Loss Rate for Debenture and Participating Securities SBICs, End of Fiscal Years 2003–2014

Fiscal Years	Specialized SBICs	Debenture SBICs	Participating Securities SBICs
2003	25.5%	10.6%	36.8%
2004	25.2%	10.5%	36.5%
2005	25.1%	9.7%	28.8%
2006	24.8%	9.1%	24.4%
2007	24.9%	8.2%	20.9%
2008	24.8%	7.4%	20.0%
2009	27.5%	7.3%	25.1%
2010	28.5%	8.0%	26.4%
2011	28.4%	7.1%	27.6%
2012	28.7%	6.3%	27.1%
2013	28.8%	6.2%	27.5%
2014	28.8%	5.2%	27.1%

Data Table for Figure 13: Small Business Investment Company (SBIC) Program: Cumulative Ultimate Losses, by Type of SBIC, End of Fiscal Years 2003–2014

Note: Dollars in billions

Fiscal Years	Specialized SBICs	Debenture SBICs	Participating Securities SBICs
2003	0.241	0.466	2.216
2004	0.239	0.508	2.635
2005	0.239	0.505	2.539
2006	0.236	0.514	2.469
2007	0.238	0.498	2.341
2008	0.237	0.500	2.460

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2009	0.262	0.539	3.144
2010	0.272	0.659	3.366
2011	0.271	0.685	3.556
2012	0.274	0.702	3.519
2013	0.275	0.799	3.588
2014	0.274	0.778	3.541

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